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BEFORE THE ARIZONA CORPORATION CO[illegible]

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IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF SOUTHWEST GAS CORPORATION DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA	)	DOCKET NO. G-01551A-04-0876

SOUTHWEST GAS CORPORATION'S POST-HEARING BRIEF

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NOVEMBER 4, 2005

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Post-Hearing Brief

of

Southwest Gas Corporation

Docket No. G-01551A-04-0876

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
MARC SPITZER
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF SOUTHWEST GAS CORPORATION DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA	)	DOCKET NO. G-01551A-04-0876

POST-HEARING BRIEF OF SOUTHWEST GAS CORPORATION

I. INTRODUCTION

The outcome of this general rate case is likely to have a significant impact on Southwest Gas Corporation's ("Southwest" or the "Company") financial profile (as viewed by investors and credit rating agencies) and, as a direct consequence, on the customers of Southwest in terms of the magnitude of future capital costs, individual customer's cost for natural gas service, and frequency of general rate cases. The most prominent issues in the case are focused on Southwest's opportunity to actually realize the authorized level of revenues, more fairly apportioning Southwest's cost of providing distribution service among customers by moving rates closer to Southwest's actual cost of service, and remedying the problems that Southwest has identified, and that none of the parties to this proceeding dispute, that are obstacles to Southwest realizing the margin that will be authorized in this proceeding.

No party disputes the notion that Southwest should be provided with a reasonable opportunity to realize a fair rate of return on the fair value of Southwest's Arizona natural gas properties. However, there are disputes among Southwest and some of the intervening parties regarding how best to achieve that objective. Once the Arizona Corporation Commission ("Commission") determines a fair rate of return (i.e., essentially, Southwest's overall cost of capital related to the depreciated original cost), potentially there are two distinct roadblocks which would frustrate Southwest's opportunity to realize the authorized rate of return: (1) denying recovery of reasonable, ongoing operating costs (through disallowances) and (2) designing rates based on volumes in such a fashion that, absent abnormally cold weather, are not likely to be realized.

The determination of a fair rate of return is somewhat of a farcical exercise, if the opportunity to achieve it is explicitly eroded by disallowing reasonable, ongoing operating costs and/or designing rates that are bound to hamper Southwest's ability to recover its costs, including capital costs. Southwest has identified the chronic and continuing phenomenon of "declining average residential consumption" as the primary barrier to realizing the commission-authorized rate of return, and Southwest has proposed the decoupling of margin recovery from gas sales as an effective means of remedying the problem through either a decoupling mechanism (conservation margin tracker) or through a rate design that effectively reduces the Company's dependency upon gas sales to recover Commission authorized margin by moving towards cost of service based rates. Unfortunately, no intervening party that opposes Southwest's proposals has offered an effective alternative.

This general rate case presents a unique and timely opportunity to improve Southwest's ability to realize the Commission-authorized margin which, in turn, should result in improved earnings and an improved opportunity to earn the Commission authorized rate of return. With improved earnings, Southwest's highly-leveraged capital structure would be strengthened, which should over time result in improved credit ratings, resulting further in lower capital costs for the benefit of the customers of Southwest. This case is also unique because the measures proposed by Southwest to improve its ability to earn its Commission authorized rate of return will also help customers, including, Southwest's low-income customers, by controlling high bills at a time when natural gas prices have reached record high prices. The Administrative Law Judge and the Commissioners are respectfully implored to seize this unique and timely opportunity.

II.
BRIEF FACTUAL BACKGROUND

On December 9, 2004, Southwest filed an application with the Commission requesting an increase in its rates throughout the state of Arizona (herein, the "Application"). Included with the Application were direct testimony and schedules that supported the Company's Application and the relief requested therein. On January 26, 2005, Staff filed a letter of sufficiency indicating that Southwest's application met the prima facie requirements for an Application for an increase in rates, as outlined in A.A.C. R14-2-103. On February 7, 2005, the Commission by and through the Administrative Law Judge, the honorable Dwight D. Nodes, issued a Procedural Order setting the matter for hearing on October 3, 2005, and the Judge issued a subsequent

Amended Rate Case Procedural Order dated March 10, 2005, setting the applicable deadlines for filing direct, rebuttal, surrebuttal, and rejoinder testimony.

Throughout the course of this proceeding, in addition to the Arizona Corporation Commission Utilities Division Staff ("Staff") and the Residential Utility Consumer Office ("RUCO"), several parties filed and were granted the right to intervene, including, the Arizona Community Action Association ("ACAA"); the Arizona Utility Investors Association ("AUIA"), the Southwest Energy Efficiency Project ("SWEEP") and the Natural Resources Defense Council ("NRDC"), and the Department of Defense ("DOD"), among others (collectively referred to as the "Intervening Parties"). On or about July 25, 2005, the Intervening Parties filed direct testimony responding to the Company's Application, and on August 23, 2005, Southwest filed rebuttal testimony. On or about September 13, 2005, the Intervening Parties filed surrebuttal testimony, and on September 23, 2005, the Company filed rejoinder testimony. In addition to the prefiled testimony that has been filed by the various parties to this proceeding, all parties have had ample opportunity to propound written discovery.

At the conclusion of the discovery stage of this proceeding, Southwest and the Intervening Parties participated in six days of hearing before Judge Nodes on October 3, 2005 through October 11, 2005.

The Intervening Parties (primarily RUCO and Staff) have challenged certain aspects of Southwest's Application and have also proposed their own recommendations regarding certain issues. However, as a result of the parties exchanging discovery and as a result of the parties having the opportunity to fully explore their positions through the filing of various rounds of prefiled testimony, there are several issues that have been ultimately conceded to by either the Company or the Intervening Party who initially set forth the opposition or proposal.

As such, in addition to those aspects of the Company's Application that were never challenged by any of the Intervening Parties, listed below are the issues that are no longer contested and that should be resolved in favor of Southwest.

A. UNCONTESTED ITEMS.

Rate Design, Tariffs, and Miscellaneous Issues:

1. Decoupling Margin Recovery from Gas Sales.

a. Staff, RUCO, SWEEP/NRDC, and AUIA each claim they support the concept of reducing Southwest's dependency upon gas sales to recover Commission authorized margin. (Diaz Cortez Direct Testimony, p. 36; Diaz Cortez Surrebuttal Testimony, p. 7; Meek Direct Testimony, p. 12; Musgrove Direct Testimony, p. 14; and Tr. pp. 979-80; 1026; 1032-33; 1154-56; 1168-72; and 1251-52.)

b. No other Intervening Party addressed this issue.

2. Class Cost of Service Study.

a. Staff accepts Southwest's proposed class cost of service study. (Berger Direct Testimony, pp. 1-6 and Bahl Direct Testimony, p. 7.)

b. No other Intervening Party opposed Southwest's study.

3. Other Service Charges.

a. Staff accepts Southwest's proposal to increase the service establishment and returned item charges, and to include language in the tariff that permits Southwest to charge the actual cost of subsequent meter tests for customers with usage greater than 180,000 therms. (Congdon Direct Testimony, p. 39 and Gray Surrebuttal Testimony, p. 14.)

b. No other Intervening Party opposed Southwest's proposal.

4. Special Residential Gas Service for Electric Generation – Schedule G-16.

a. Staff accepts Southwest's proposal to eliminate this schedule. (Gray Direct Testimony, p. 42.)

b. No other Intervening Party opposed Southwest's proposal.

5. Gas Service to Armed Forces – Schedule G-35.

a. Staff and the DOD accept Southwest's proposal to reclassify customers from this schedule to the applicable General Gas Service Schedule – G-25. (Neidlinger Surrebuttal Testimony, p. 2 and Tr. pp. 1197-98.)

b. No other Intervening Party opposed Southwest's proposal.

6. Cogeneration Gas Service – Schedule G-60.

a. Staff accepts Southwest's proposal to change the title of Schedule G-60 to "Electric Generation Gas Service" and to have the rate schedule apply to all electric generation customers; to include the G-60 rate schedule in the monthly purchased gas cost adjustment provision; and to retain the basic service charge as the customer's otherwise applicable gas sales tariff schedule basic service charge. (Gray Direct Testimony, pp. 50-52.) Southwest also agrees with Staff's recommendation to develop and propose provisions to protect core customers from the potential impact of 5 MW or larger customers by agreeing to include the special procurement language from its Schedule G-30 as a special condition in this rate schedule. (Congdon Rebuttal Testimony, p.36.)

b. No other Intervening Party opposed Southwest's or Staff's proposals.

7. Transportation of Customer Secured Natural Gas – Schedule T-1.

a. Staff accepts Southwest's proposal to eliminate tariff sheet fourteen and to reserve it for future use; to add a footnote to tariff sheet thirteen describing the transportation rates; and to make corresponding changes to the Transportation Schedule T-1, including deleting the standard form of service agreement. (Gray Direct Testimony, p. 54.)

b. No other Intervening Party opposed Southwest's proposal.

8. Federal Energy Regulatory Commission Filings.

a. Southwest accepts Staff's proposal that Southwest provide Staff a copy of any filings that it makes in any Federal Energy Regulatory Commission proceedings that affect Arizona. (Gray Direct Testimony, p. 59.)

b. No other Intervening Party opposed Staff's proposal.

9. Bill Formats.

a. Southwest accepts with Staff's proposal to provide explanations of "Base Tariff Rate" and "Rate Adjustment" on the reverse side of its bills. (Gray Direct Testimony, p. 59 and Tr. p. 270.)

b. No other Intervening Party addressed this issue.

10. Base Cost of Gas.

a. Southwest accepts Staff's proposal to effectively eliminate the base cost of gas component by setting it at zero and having the monthly PGA rate now include the previously separate base cost of gas amount. (Gray Direct Testimony, pp. 11-16.)

b. No other Intervening Party addressed this issue.

11. El Paso Laterals.

a. Southwest shares the concerns expressed by Staff with regard to lateral issues involving El Paso, and Southwest agrees to continue to study cost-effective and reasonable means to either own its own system or own access to supplies that come to its system. (Gray Surrebuttal Testimony, pp. 16-17; Moody Rejoinder Testimony, p. 5; and Tr. pp. 455-56.)

b. No other Intervening Party addressed this issue.

12. Title Assignment.

a. Southwest has withdrawn its request to eliminate Title Assignment from its Tariff. (Congdon Rebuttal Testimony, pp. 40-41.)

13. Purchasing and Gas Procurement.

a. Southwest accepts Staff's proposals to conduct a best practices review of the fuel procurement and planning functions by an impartial outside organization and review non-gas commodity hedging; provide a check and balance in the fuel procurement process that would separate contract award authority from invoice approval authority; eliminate the use of cell phones during term fuel bidding and negotiating activities and to ensure all discussions are recorded and bidding and negotiation activities are observed by neutral personnel; perform a review of available portfolio evaluation software; investigate how peer utilities address commodity price hedging, with an emphasis on steel; develop and implement standard practices and procedures, within 60 days from the date of a Commission decision in this proceeding, that define or establish measurement criteria for what constitutes substantial stock or other financial interest in any supplier and applies to individuals within the purchasing and gas procurement departments; and to file a report in Docket Control within 60 days from the date of a Commission decision in this matter providing the scope of work for portfolio evaluation software and non-gas commodity price hedging, with an emphasis on steel. (Moody Rejoinder Testimony, pp. 2-4 and Tr. pp. 1107-1109.)

b. No other Intervening Party addressed this issue.

14. Demand Side Management/Energy Efficiency Programs.

a. Staff, RUCO, and SWEEP/NRDC each support the Company's proposal to expand the current demand side management/energy efficiency ("DSM") programs from two to nine programs; the Company's proposed funding levels of the programs (with the exception of the Low Income Energy Assistance and the Energy Star Home programs); each party supports the use of a collaborative group to further refine the programs for submittal to the Commission for final approval on how the program will be administered; and each party either supports or is not opposed to Southwest filing a final DSM plan with guidelines on plan administration, budgets, and cost-effectiveness analysis for Commission review and approval within 120 days of the Commission's decision in this proceeding. (Scott Rebuttal Testimony, pp. 1-6; Scott Rejoinder Testimony, pp. 1-4; Schlegel Surrebuttal Testimony, p. 2; Diaz Cortez Direct Testimony, pp. 23-25; Irvine Surrebuttal Testimony, p. 9; and Tr. pp. 952, 1273-77; and 1022-24.)

b. No other Intervening Party addressed this issue.

Cost of Capital:

1. Staff, RUCO, AUIA, and Southwest agree that the Commission should utilize a hypothetical capital structure. (Wood Direct Testimony, pp. 8-33; Rigsby Direct Testimony, p. 44; Meek Direct Testimony, pp. 13-14; and Hill Direct Testimony, p. 23.)

2. No other Intervening Party opposed utilizing a hypothetical capital structure.

Cost of Debt:

1. Southwest accepts Staff's proposal to use the Company's March 31, 2005 embedded cost of long-term debt of 7.61%, provided by the Company in response to Staff's Data Request No. SH-12-2. (Hill Direct Testimony, p. 24 and Exhibit (SGH-1), Schedule 2, Page 6 of 6.)

2. No other Intervening Party opposed Staff's proposal.

Operating Income and Rate Base Adjustments:

1. **Property Tax Expense - Operating Income Adjustment.**

   a. Southwest agrees with Staff and RUCO that using the January 1, 2006 property tax assessment ratio of 24.5% more appropriately reflects the level of property tax that will be experienced during the period that rates pursuant to this proceeding will be in effect. (Moses Rejoinder Testimony, p. 3.)

b. Southwest also agrees with Staff and RUCO that the legislative change effective January 1, 2005, that removes property value related to Contributions in Aid of Construction (CIAC) from the Arizona property tax calculation, should apply in this proceeding. (*Id.*) The removal of CIAC from the Arizona property tax calculation in this proceeding will more appropriately reflect the property tax formula that will be in effect concurrent with rates pursuant to this proceeding. (*Id.*)

c. RUCO agrees with Southwest that the $25,153,605 for Transportation Equipment shown on Southwest Supporting Schedule C-2, Adjustment No. 18, Sheet 1 of 1, Line 4 (c) is correct. (Tr. pp. 926-28.)

d. No other Intervening Party addressed these issues.

2. Injuries and Damages - Operating Income Adjustment.

a. Southwest and RUCO agree with Staff's proposal to use a ten year average for the normalization of the self-insured portion of liability claims and to reduce the Company's original adjustment by $430,535. (Dorf Surrebuttal Testimony, p. 9 and Tr. p. 928.)

b. No other Intervening Party addressed this issue.

3. Interest on Customer Deposits - Operating Income Adjustment.

a. Staff accepts Southwest's proposed adjustment of $717,364, if a 6% interest rate on customer deposits is retained. (Aldridge Rebuttal Exhibit RLA-4, ln. 3(b) and Tr. p. 1098.)

b. No other Intervening Party opposed Southwest's proposal.

4. Completed Construction Not Classified Depreciation Expense – Operating Income Adjustment.

a. Southwest agrees with RUCO that depreciation expense should be reduced by $1,248 to reflect the retired plant related to completed construction not classified pipe replacement work orders that RUCO is allowing. (Aldridge Rebuttal Exhibit RLA-8, ln. 11(d) and Tr. p. 543.)

b. No other Intervening Party addressed this issue.

5. Sarbanes Oxley Compliance Costs – Operating Income Adjustment.

a. Southwest agrees with RUCO that the Sarbanes Oxley fees estimated in the filing should be updated to actual costs. (Diaz Cortez Direct Testimony, pp. 15-16.) This increases administrative and general expenses by $240,016, and reduces regulatory amortization costs by $12,932.

b. Staff agreed to update Sarbanes Oxley costs to actual, but only to the extent those updated costs provided a starting point for its proposed disallowances, with which the Company does not agree.

a. No other Intervening Party addressed this issue.

6. **Transmission Integrity Management Program – Operating Income Adjustment.**

   a. Southwest agrees with RUCO's proposed reduction to the Company's original level of transmission integrity management program ("TRIMP") expense. The Company agrees that the TRIMP amortization expense should be $138,365 ($1,183,333 - $1,044,968) and test year annual expense should be $603,677 ($2,091,964 - $1,488,287). (Diaz Cortez Direct testimony pp. 17-19.)

   b. No other Intervening Party opposed RUCO's proposal.

7. **Accumulated Provision for Depreciation – Rate Base Adjustment**

   a. Southwest agrees with RUCO's adjustment to the Accumulated Provision for Depreciation, which was made to account for what the balance would have been had the Company continued to depreciate certain balances on its books from the prior rate case test year to the end of the test year in the current case. This reduces rate base by $56,182 (Moore Direct Testimony, Schedule RLM-3, Page 1, Column (d).)

   b. No other Intervening Party addressed this issue.

8. **Working Capital (Lag Day Calculations) - Rate Base Adjustment.**

   a. Southwest agrees with RUCO's proposed adjustment to increase the "Other O&M" lag day calculation to 31.05 days and the corresponding $625,957 increase to prepayments.

   b. No other Intervening Party addressed this issue.

9. **Working Capital Calculation - Rate Base Adjustment.**

   a. Southwest agrees with RUCO's proposal to recalculate the lead-lag study replacing the Company's proposed expenses with RUCO's proposed expenses. Ultimately, the Commission should recalculate the lead-lag study using the Commission's adopted expense amounts. (Diaz Cortez Direct Testimony, p. 11)

   b. No other Intervening Party addressed this issue.

10. **Miscellaneous Intangible Plant - Rate Base Adjustment**

   a. Southwest agrees with RUCO's proposed adjustment to update its construction work in progress ("CWIP") estimates of plant closings to actual, remove a project from CWIP that did not close to plant, and to remove assets expiring before December 31, 2004 from rate base, resulting in a reduction of rate base of $314,372. (Diaz Cortez Direct Testimony, pp. 9-10 and Tr. 952.)

   b. No other Intervening Party addressed this issue.

11. **Amortization of Miscellaneous Intangible Plant – Rate Base and Operating Income Adjustment.**

   a. Southwest agrees with Staff's adjustment to remove a project from the Company's proposed CWIP/construction completed not classified ("CCNC") adjustment that did not close to plant when anticipated, and to update the estimate of CWIP plant closings to actual. After allocation to Arizona, rate base is reduced by $284,866 and operating expense is reduced by $94,962. (Rogers Direct Testimony, pp. 3-4 and Rogers Direct Testimony, Schedule DRR-17.)

   b. RUCO made this adjustment and proposed an additional adjustment in order to remove the net plant related to projects whose amortizations were set to expire on or before December 31, 2004 (Diaz Cortez Direct Testimony, pp. 9-10; Diaz Cortez Direct Testimony, Schedule MDC-2 Lns 1-5; Diaz Cortez Direct Schedule MDC-2, Lns 6-9 and 16-19; and Diaz Cortez Surrebuttal Testimony, p. 3). Southwest agrees with RUCO's adjustment because the Company had only removed the amortization expense related to those projects whose amortizations were set to expire on or before December 31, 2004 in its filing. As such, Southwest agrees with RUCO's adjustment to reduce rate base by $29,485.

c. Southwest agrees with RUCO's proposed reduction of amortization expense of $164,924. (Diaz Cortez Direct Testimony pp. 19-20.)

d. No other Intervening Party addressed this issue.

12. Pipe Replacement – Rate Base and Operating Income Adjustment.

a. RUCO agrees with Southwest's proposal to modify the scheduled pipe replacement write offs using a 40 year standard. (Diaz Cortez Direct Testimony, p. 7.)

b. Southwest agrees with RUCO's pipe replacement adjustment related to Aldyl A and ABS pipe replacements that took place from January 2000 through August 31, 2004, resulting in a decrease in rate base of $785,100 and a related decrease in depreciation expense of $43,650. (Diaz Cortez Direct Testimony, p. 7 and Mashas Rebuttal Testimony, pp. 15-16.)

c. No other Intervening Party opposed Southwest's and RUCO's proposals.

B. CONTESTED ITEMS.

The following issues are those aspects of the Company's Application that were initially challenged or proposed by an Intervening Party and that currently remain in dispute between the Company and one or more of the Intervening Parties.

Rate Design, Tariffs, and Miscellaneous Issues:

1. The Conservation Margin Tracker.

a. Staff, RUCO, and SWEEP/NRDC oppose the adoption of the conservation margin tracker ("CMT"). (Tr. pp. 952-53, 1030, and 1121.)

b. No other Intervening Party opposed Southwest's proposal.

2. Allocation of Margin to Customer Classes.

a. Staff and RUCO both challenge Southwest's proposed allocation of margin among customer classes, and propose their own significantly different allocations. (Congdon Direct Testimony, page 9). RUCO discusses its proposed allocation of margin to residential customers, but offers no explanation of how it established non-residential customer class margins. (Diaz Cortez Direct Testimony, pp. 32-33.) Staff also offers limited explanation for the basis of its allocation of margin. (Gray Direct Testimony, p. 31 and Gray Surrebuttal Testimony, pp. 9-10.)

b. Southwest submits that all commodity rates (or price per therm rates) should be set consistent with Southwest's proposed methodology for allocating margin to customer classes. Congdon Direct Testimony, p. 9 and Schedule H-6, Sheets 1-2.)

c. No other Intervening Party opposed Southwest's proposal.

3. **Residential Gas Service– Schedule G-5.**

a. Staff and RUCO oppose Southwest's proposed declining block rate design consisting of a basic service charge of $12.00, with a first tier margin rate of $.84286 per therm, with a second tier margin rate of $.25000 per therm (with the conservation margin tracker) and a basic service charge of $16.00, with a first tier rate of $.66454, with a second tier rate of $.15000 (without the conservation margin tracker). (Congdon Direct Testimony, pp. 16-17.)

b. Staff proposes its own declining block rate design consisting of a basic service charge of $9.70, with a first tier margin rate of $.54200 per therm, and a second tier margin rate of $.50100. (Gray Surrebuttal Testimony, Supplemental Schedules filed with Summary of Testimony.)

c. RUCO proposes its own flat rate design consisting of a basic service charge of $10.11 and a per therm rate of $.494952. (Moore Surrebuttal Testimony, Schedule SUR-RLM-16.)

d. No other Intervening Party opposed Southwest's proposals.

4. **Multi-Family Residential Gas Service – Schedule G-6.**

a. Staff challenges Southwest's proposed multi-family rate schedule. (Gray Direct Testimony, p. 35.)

b. RUCO accepts Southwest's proposal. (Diaz Cortez Surrebuttal Testimony, p. 9.)

c. No other Intervening Party opposed Southwest's proposal.

5. **Low Income Residential Gas Service – Schedule G-10.**

   a. Staff challenges Southwest's proposal to provide the low income discount year round; to eliminate the low income residential gas service schedule; and to incorporate the low-income discount provisions into its proposed single and multi-family residential rate schedules. (Gray Direct Testimony, p. 36.)

   b. RUCO and ACAA accept Southwest's proposal. (Diaz Cortez Surrebuttal Testimony, p. 9 and Tr. 522.)

   c. No other Intervening Party opposed Southwest's proposal.

6. **Special Residential Gas Service for Air Conditioning – Schedule G-15.**

   a. Staff challenges Southwest's recommendation to eliminate this schedule. (Gray Direct Testimony, p. 41.)

   b. RUCO accepts Southwest's proposal. (Diaz Cortez Surrebuttal Testimony, p. 9.)

   c. No other Intervening Party opposed Southwest's proposal.

7. **Master Metered Mobile Home Park Gas Service – Schedule G-20.**

   a. Staff challenges Southwest's proposal to increase the basic service charge to $100 and recommends the basic service charge be increased from $50 to $60 per month. (Gray Direct Testimony, p. 43.)

   b. No other Intervening Party opposed Southwest's proposal.

8. **General Gas Service – Schedule G-25.**

   a. Staff challenges Southwest's proposal to create a new general service rate schedule applicable to customers who use less than 600 therms per year and to revise the billing demand calculation for general service customers using more than 180,000 therms to equal customers' non-coincident peak month throughput. (Gray Direct Testimony, pp. 43-44.)

b. RUCO accepts Southwest's proposal. (Diaz Cortez Surrebuttal Testimony, p. 9.)

c. Staff, RUCO, and Southwest each propose their own respective basic service charges for the general gas service schedules. (Congdon Rebuttal Testimony, p. 31.)

d. The DOD proposes a billing demand equal to a customer's maximum throughput during a defined six month winter season. (Neidlinger Surrebuttal Testimony, p. 3.)

e. No other Intervening Party opposed Southwest's proposal.

9. Air Conditioning Gas Service – Schedule G-40.

a. Staff challenges Southwest's proposal to charge this class of customers a basic service charge of $25. (Gray Direct Testimony, p. 48.)

b. No other Intervening Party opposed Southwest's proposal.

10. Street Lighting Gas Service – Schedule G-45.

a. Staff challenges Southwest's proposal to charge this class of customers a per therm rate that is consistent with the Company's proposed allocation of margin to customer classes by proposing to increase the per therm rate from $.47648 to $.54. (Gray Direct Testimony, p. 49.)

b. No other Intervening Party Southwest's proposal.

11. **Gas Service for Compression on Customer's Premises – Schedule G-55.**

   a. Staff challenges Southwest's proposal to increase the basic service charge to $12, $25, and $350, for residential customers, small customers, and large customers, respectively. (Gray Direct Testimony, p. 49.)

   b. No other Intervening Party opposed Southwest's proposal.

12. **Cogeneration Gas Service – Schedule G-60.**

   a. Southwest challenges Staff's proposed per therm rate of $.11000 because Staff's rate does not reflect Southwest's proposed basic service charges and is not based upon Southwest's proposed allocation of margin to customer classes. (Congdon Direct Testimony, p. 12.)

   b. No other Intervening Party opposed Staff's proposal.

13. **Small Essential Agricultural User Gas Service – Schedule G-75.**

   a. Staff challenges Southwest's proposal to close this schedule to new service and to reclassify customers whose bills would be reduced to general gas service rate schedules. (Gray Direct Testimony, pp. 52-53.) Staff also challenges Southwest's proposed basic service charge of $150 per month. (*Id.*)

   b. No other Intervening Party opposed Southwest's proposal.

14. **Natural Gas Engine Gas Service – Schedule G-80.**

   a. Staff challenges Southwest's proposal to shield this customer class from any increase in margin and to increase the off-peak basic service charge to $100, with a corresponding reduction to the commodity rate. (Gray Direct Testimony, p. 53.)

   b. No other Intervening Party opposed Southwest's proposal.

15. **Billing Determinants.**

a. RUCO challenges the Company's proposed billing determinants. (Tr. pp. 923-24.)

b. No other Intervening Party addressed this issue.

16. **Purchased Gas Adjustor Mechanism.**

a. Southwest challenges Staff's proposal to increase the bank balance trigger level of the purchased gas adjustor from $22.4 million to $29.2 million and to have an officer certify the PGA reports. (Gray Direct Testimony, pp. 21 and 24-25; Congdon Rebuttal Testimony, pp. 39-40; Moody Rebuttal Testimony, p. 7; and Gieseking Rejoinder Testimony, pp. 10-11.)

b. No other Intervening Party addressed this issue.

17. **Interest on Customer Deposits.**

a. Staff challenges Southwest's proposal to have the same interest rate for deposit accounts and balancing accounts (purchase gas adjustor, low income rate assistance, and demand side management). (Gray Direct Testimony, pp. 54-55 and 57-58.)

b. No other Intervening Party opposed Southwest's proposal.

18. **Four Hour Service Window.**

a. Southwest challenges Staff's proposal that Southwest implement, as a standard practice, a four hour service window option for its customers. (Gray Rebuttal Testimony, p. 14 and Palacios Rejoinder Testimony, pp. 3-7.)

b. No other Intervening Party addressed this issue.

19. Gas Technology Institute Funding.

a. Southwest challenges Staff's proposal that Southwest participate in certain Gas Technology Institute ("GTI") programs by funding GTI $681,712 annually. (Gray Direct Testimony, p. 7; Marek Rebuttal Testimony, pp. 2-6; and Tr. 475-76 and 481-83.)

b. No other Intervening Party addressed this issue.

20. Southwest's Bill Stock.

a. Southwest challenges Staff's proposal that Southwest revise its bill stock to include a box for additional contributions to the energy share program and to customize the bill stock for Arizona by removing references to California and Nevada. (Gray Direct Testimony, pp. 55-56 and 59 and Congdon Rebuttal Testimony, p. 38.)

b. No other Intervening Party addressed this issue.

21. Demand Side Management/Energy Efficiency Programs.

a. RUCO challenges Southwest's and SWEEP/NRDC's proposal for a performance incentive for complying with the programs. (Diaz Cortez Surrebuttal Testimony, pp. 11-12.)

b. Staff, RUCO, and SWEEP/NRDC challenge Southwest's proposal that the programs only be approved if a decoupling mechanism is also approved, so as to eliminate the financial disincentive and financial penalty the Company will experience and suffer if its margin recovery is not decoupled from gas sales.

(Musgrove Surrebuttal Testimony, p. 8; Diaz Cortez Surrebuttal Testimony, p. 11; and Schlegel Surrebuttal Testimony, p. 3.)

c. Staff challenges SWEEP/NRDC and the Company's proposal to increase the funding level pertaining to the Energy Star Home program and to have the LIEC program part of the DSM funding. (Irvine Surrebuttal Testimony, pp. 2-4 and 6-7.)

d. No other Intervening Party addressed these issues.

Cost of Capital:

1. Staff challenges RUCO's and the Company's proposal to use a 42% common equity component in the hypothetical capital structure. (Hill Direct Testimony, p. 23.)

2. No other Intervening Party opposed Southwest's and RUCO's hypothetical capital structure proposal.

3. Staff, RUCO, and Southwest each submit their own proposed recommendations and methodologies for calculating the return on equity and rate of return, and each party challenges the other party's respective proposals. (See generally, Hanley Direct Testimony; Hanley Rebuttal Testimony; Hanley Rejoinder Testimony; Wood Direct Testimony; Wood Rebuttal Testimony; Hill Direct Testimony; Hill Surrebuttal Testimony; Rigsby Direct Testimony; and Rigsby Surrebuttal Testimony.)

Operating Income and Rate Base Adjustments:

1. **Transmission Integrity Management Program - Operating Income Adjustment.**

   a. Staff challenges the Company's proposal to recover 100% of its costs associated with complying with this federal mandate by recommending a disallowance of $742,044. (Tr. p. 1082.)

   b. No other Intervening Party opposed Southwest's proposal.

2. **Sarbanes Oxley Compliance Costs - Operating Income Adjustment.**

   a. Staff challenges Southwest's proposal to recover 100% of its costs associated with complying with this federal mandate by recommending a disallowance of $145,716. (Tr. pp. 1082-83.)

   b. RUCO accepts the Company's proposal. (Tr. p. 984.)

   c. No other Intervening Party opposed Southwest's proposal.

3. **The Total Compensation of 37 Southwest Employees.**

   a. Southwest challenges RUCO's proposal to disallow $2,892,434 from the Company's cost of service, which amount represents the total compensation of 37 Southwest employees. (Moore Direct Testimony, pp. 15-16.)

   b. No other Intervening Party addressed this issue.

4. **Management Incentive Program - Operating Income Adjustment.**

   a. RUCO and Staff both challenge the Company's proposal to recover 100% of the costs associated with the management incentive plan by recommending disallowances of 67% and 50%, respectively. (Diaz Cortez Direct Testimony, p. 20 and Dorf Direct Testimony, p. 21.)

b. No other Intervening Party opposed Southwest's proposal.

5. Supplemental Executive Retirement Plan - Operating Income Adjustment.

a. RUCO challenges the Company's proposal to recover 100% of its cost associated with its supplemental executive retirement plan by proposing a disallowance of $1,566,073. (Moore Direct Testimony, pp. 28-29.)

b. No other Intervening Party opposed Southwest's proposal.

6. Miscellaneous Expenses - Operating Income Adjustment.

a. RUCO challenges Southwest's proposal to recover certain miscellaneous expenses by proposing a disallowance of $277,039. (Moore Surrebuttal Testimony, pp. 21-22.)

b. No other Intervening Party opposed Southwest's proposal.

7. American Gas Association Dues - Operating Income Adjustment.

a. RUCO challenges the Company's proposal to recover certain American Gas Association dues by proposing a disallowance of $75,385. (Moore Direct Testimony, p. 22.)

b. No other Intervening Party opposed Southwest's proposal.

8. Labor Annualization - Operating Income Adjustment.

a. RUCO challenges Southwest's proposal to include the 2005 wage increases in its Application by recommending a disallowance of $1,326,409 (exclusive of the wage increases applicable to the 37 employees that RUCO recommends be disallowed from the cost of service). (Tr. pp. 924 and 1085.)

b. No other Intervening Party opposed Southwest's proposal.

9. Deferred Taxes - Rate Base Adjustment.

a. Staff challenges the Company's adjustment to decrease deferred taxes and increase rate base by $21,120,694 to properly reflect a recent change in law that became effective August 3, 2005. (Tr. p. 1084.)

b. No other Intervening Party opposed Southwest's proposal.

10. Pipe Replacement – Rate Base Adjustment.

a. RUCO challenges the Company's proposal regarding the effective date for applying new percentages to pipe replacement write-offs of Aldyl A pipe and recommends the continued write-off of steel pipe based upon a misunderstanding of the information provided by Southwest to RUCO in response to RUCO's data request 15-1. (Diaz Cortez Surrebuttal Testimony, pp. 12-13; Tr. p. 985; and Exhibit A-47) RUCO's recommendation reduces rate base by $1,197,585 and reduces related depreciation expense by $62,242.

b. No other Intervening Party opposed Southwest's proposal.

11. Completed Construction Not Classified - Rate Base Adjustment and Operating Income Adjustment.

a. RUCO challenges Southwest's recovery of CCNC rate base items totaling $1,601,627, of which, $1,445,358 is direct plant and $116,232 is the portion of System Allocable plant that is allocable to Arizona. (Moore Direct Testimony, Schedule RLM-4.) There is a related depreciation expense reduction of $56,742 for direct plant and $15,895 for the portion of system allocable plant that is allocable to Arizona.

b. No other Intervening Party opposed Southwest's proposal.

III.
ARGUMENT

In generally the same order that Southwest presented its case at the hearing (Rate Design, Cost of Capital, and Revenue Requirement), listed below are the arguments and legal points and authorities that the Company submits to the Commission in support of its requested relief in this proceeding.

A. UNCONTESTED ITEMS.

With regard to all aspects of the Company's Application that were never challenged by an Intervening Party, and with regard to those aspects of the Company's Application that have been conceded by either the Company or the Intervening Party who initially set forth the challenge or the proposal, Southwest contends that, based upon the Company's Application and all documents and pleadings on file herein, and all testimony presented at the time of the hearing of this matter, Southwest has met its burden of proof with regard to each particular request for relief set forth in the Application, and the relief requested through its testimony on file herein, and that the Commission should grant Southwest the relief requested herein. See, *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799 (D.C. Cir. 1981).

B. RATE DESIGN, TARIFFS, AND MISCELLANEOUS ISSUES.

1) Legal Argument.

The evidence presented in this proceeding is uncontradicted with regard to the following:

- That by placing more of Southwest's margin in the volumetric rate, the greater the risk Southwest has of not recovering its margin. (Tr. pp. 970, 990-91, 1204.)

- That Southwest has a significant financial disincentive to promote conservation when it has a volumetric rate design that has margin in the volumetric rate. (Tr. pp. 1048, 1122, and 1169-70.)
- That Southwest has experienced significant residential declining use per customer for more than a decade. (Tr. pp. 154, 1134.)
- That Southwest has been unable to realize its authorized rate of return for ten out of the last eleven years, largely due to the declining residential use per customer. (Mashas Direct Testimony, p. 12 and Tr. 1163.)
- That there has been no evidence presented in this proceeding to suggest that this declining use phenomena will cease. (Tr. p. 999.)
- That Southwest's low-income and non-low-income residential customer classes have a remarkably similar natural gas usage profile. (Tr. pp. 221, 224, and 306-07 and Exhibit A-50.)
- That Staff's and RUCO's respective residential rate design proposals result in greater potential exposure to high winter bills for all customers, including low-income customers. (Congdon Rejoinder Testimony, p. 3-6; Tr. pp. 209-210, 274-75, 304, and 1231; and Exhibit A-51.)
- That by loading margin into the volumetric rate, it increases the risk Southwest will not recover its margin, and, in an environment of declining residential use per customer, it will negatively impact Southwest's ability to earn its authorized rate of return. (Tr. pp. 1018, 1031, 1051, and 1201.)

- That Staff's and RUCO's respective rate design proposals assume their will be no further decline in usage; their proposals offer no relief to Southwest in the event there is a further decline in usage; and Staff and RUCO have presented no evidence to support this assumption. (Tr. pp. 996, 1230.)
- Staff, RUCO, SWEEP/NRDC, and AUIA each claim they support the concept of reducing Southwest's dependency upon gas sales to recover Commission authorized margin. (Diaz Cortez Direct Testimony, p. 36; Diaz Cortez Surrebuttal Testimony, p. 7; Meek Direct Testimony, p. 12; Musgrove Direct Testimony, p. 14; and Tr. pp. 979-80; 1026; 1032-33; 1154-56; 1168-72; and 1251-52.)

The evidence suggests that the trend of declining residential use per customer will likely continue because none of the Intervening Parties are opposed to increasing DSM funding; none of the Intervening Parties contend that these programs will not work; a well funded DSM program can yield a 20% reduction in gas use; and none of the Intervening Parties dispute Southwest's contention that it has already experienced a decline in use per customer among its residential class since the filing of this Application. (Schlegel Direct Testimony, p. 3 and Tr. pp. 161-162.) Accordingly, Southwest has presented rate design proposals and a decoupling mechanism proposal to remedy these issues.

Other positive characteristics of Southwest's proposals are that they improve stability and reduce intra-class subsidies. The evidence unequivocally establishes that Southwest's residential rate design proposals are the most stable. (Tr. p. 1001 and 1245.) As such, customers will experience less volatility during the winter months, especially during colder than normal winters, and the Company will improve the consistency in its revenue stream. (Tr. pp. 1230-31.) The evidence is also undisputed that Southwest's rate design proposals will reduce the various intra-class subsidies that currently exist, as opposed to Staff's or RUCO's rate design proposals, thus reducing the existing subsidy that large-volume/low-income customers are currently providing to low-use residential customers. (Tr. p. 1214.)

In light of the undisputed evidence, any Commission approved rate design for the Company that does not sufficiently address the negative impact from the continuous decline in residential use per customer, the financial harm suffered if ordered to further promote conservation, or the increased risk of not recovering Commission authorized margin by failing to separate margin recovery from gas sales may be violative of the just and reasonable standards set forth in Article 15, §3 of the Arizona Constitution, and tantamount to a taking of private property for public use in violation of the due process clause and the prohibitions in the Fifth and Fourteenth Amendments to the United States Constitution, as well as other legal principles.

i) Points and Authorities.

(1) *Authority of the Commission.*

The Commission has the "full power to, and shall, prescribe **just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected**, by public service corporations within the state for service rendered therein" (emphasis added) (Ariz. Const. art. 15, §3). Although the Commission's authority to prescribe rates for public utilities is plenary, **the Commission's rate-making authority is subject to the "just and reasonable" clauses of Article 15, Section 3 of the Arizona Constitution**. (Emphasis added.) *See Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169 (2001).

As such, when the Commission is considering the various rate design proposals it is bound to the "just and reasonable" standards set forth in Article 15, §3 of the Arizona Constitution.

(2) ***Rates Should Be Designed To Recover a Utility's Authorized Cost of Service.***

A general theory of utility regulation is that total revenue, including income from rates and charges, should be sufficient to meet the utility's operating costs and to give the utility and its stockholders a reasonable rate of return on the utility's investment. *Scates v. Arizona Corporation Commission,* 118 Ariz. 531, 578 P.2d 612 (1978) (*Citing* ARS Const. art. 15, §3; ARS §40-250.) Rates established by the Commission should meet overall operating costs of a utility and produce a reasonable rate of return. (*Id.*) Rates cannot be considered just and reasonable if they fail to recover a utility's authorized operating expenses or if they fail to produce a reasonable rate of return. (*Id.*)

There is also a "constitutionally based floor below which a rate ceiling set by a regulatory agency will be reversed by the courts as confiscatory." *Peoples Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319, 328 (Wash. 1985). This is based on the prohibitions in the Fifth and Fourteenth Amendments to the United States Constitution against taking private property for a public use without just compensation. (*Id.*)

Accordingly, a rate design that does not permit the utility to recover its authorized cost of service or that fails to provide the utility an opportunity to earn a reasonable rate of return is not just and reasonable, and may be violative of the due process clause as a taking or seizing of private property for public use without just compensation. See, *Scates v. Arizona Corporation*

Commission, 118 Ariz. 531, 578 P.2d 612 (1978); see also, *Peoples Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (1985).

(3) ***Southwest Has Met Its Burden of Proof To Produce Evidence That Its Proposed Rates Are Reasonable.***

When a utility seeks a rate increase, the utility is not required to demonstrate in their case in chief that all expenditures were prudent, rather, "where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the application has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent." *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). Once an opponent to a general rate case makes a showing of improvidence, the burden of persuasion in producing rebuttal evidence falls squarely on the utility to show that the requested relief **is reasonable**. (*Id.*) Southwest has met its burden of proof by presenting evidence demonstrating the benefits of its proposed rate design.

ii) **<u>The Conservation Margin Tracker and Rate Design</u>.**

Notwithstanding the challenges to Southwest's Application and its various rate design proposals, Southwest submits that its rate design proposals, including the CMT, are just and reasonable because they appropriately balance the interests of investors and customers, and should be approved by the Commission.

(1) *The Conservation Margin Tracker.*

Southwest proposed the CMT as an equitable means to decouple the Company's margin recovery from its gas sales. (Gieseking Direct Testimony, pp. 4-5 and 17-23.) The CMT is a reasonable cost recovery technique because it eliminates the Company's financial disincentive associated with promoting DSM programs; it does not discourage consumers from conserving natural gas, because the more a customer conserves, the more the customer will save; it only charges customers for the fixed costs of service that the Commission authorized in the Company's general rate case; it protects customers from the Company earning more than its Commission authorized margin per customer during a colder than normal heating season; it protects the Company from declining residential use per customer; and it provides Southwest with a more consistent revenue stream by reducing its dependency upon gas sales to recover Commission authorized margin per customer, thus likely having a positive impact on its ratings with credit agencies and reducing borrowing costs that are necessary to fund infrastructure growth. (Gieseking Direct Testimony, pp. 18-23; Gieseking Rebuttal Testimony, pp. 14-22; Gieseking Rejoinder Testimony, pp. 5-9.)

Furthermore, Southwest is willing to modify the CMT or to accept other alternative means to decoupling the Company's margin recovery from gas sales in order to sufficiently address the problems that all parties to this proceeding have acknowledged. (*Id.*)

As noted above, no Intervening Party challenges the problems expressed by Southwest in its Application and its testimony regarding a volumetric rate design that places significant amounts of margin in the volumetric rate, including, without limitation, the significant financial disincentive to promote conservation; the increased risk of not recovering its margin; the potential negative impacts on its ability to earn its authorized rate of return due in part to the continued decline in residential use per customer, and the increased risk to customers of higher bills during a colder than normal winter. (Tr. pp. 970, 990-91, 1018, 1031, 1051, 1048, 1122, 1169-70, 1201, and 1204.) As such, it is problematic that, contrary to the uncontradicted evidence presented in this proceeding, Staff and RUCO have knowingly presented rate design proposals that: (1) assume there will be no further decline in usage per customer; (2) do not sufficiently reduce the Company's dependency upon gas sales to recover its authorized margin; (3) do not sufficiently address the Company's financial disincentive for supporting increased DSM programs; and (4) increase customers' exposure to high winter bills. (Congdon Rejoinder Testimony, p. 3-6; Tr. pp. 209-210, 275; 952-53, 996, 1048, 1122, 1169-70, and 1230; and Exhibit A-51.)

(a) *RUCO.*

RUCO failed to present any sound justification as to why it does not support the CMT. First, contrary to RUCO's assertion that the CMT should not apply to the residential class only, Company witness Ed Gieseking explained why having the CMT only apply to the residential class is not improper. (Diaz Cortez Direct Testimony, pp. 29-30; Gieseking Rebuttal Testimony, pp. 5-8; and Tr. p. 376.) Furthermore, Southwest offered to have the CMT apply to all customer classes, and RUCO never accepted or rejected the Company's offer. (Gieseking Rebuttal Testimony, p. 8; Diaz Cortez Surrebuttal Testimony, p. 5; and Tr. p. 376.)

Second, contrary to RUCO's initial assertion that customers pay for therms of gas they do not use (something RUCO later acknowledged was not true in its surrebuttal testimony), Mr. Gieseking explained why customers only pay for therms of gas they actually consume. (Diaz

Surrebuttal Testimony, p. 6 and Gieseking Rebuttal Testimony, pp. 14-16.) With the CMT, the customer only pays the Commission authorized margin to cover the fixed costs of having gas service available to them twenty four hours a day, seven days a week. (Gieseking Rebuttal Testimony, pp. 14-16 and Rejoinder Testimony, pp. 6-7.) The customer saves all the gas costs, plus potentially all the commodity margin component, associated with their conservation efforts. (*Id.*) In fact, Mr. Gieseking also explained that if a customer consumes more gas, they pay a larger CMT surcharge; whereas, if a customer conserves, they will pay less of the CMT surcharge because the CMT surcharge is based upon customer usage. (Gieseking Rejoinder Testimony, pp. 8-9 and Tr. pp. 417, 1149.) As a result, the CMT should not discourage conservation and, in fact, the CMT provides customers an incentive to conserve, and provides customers a greater incentive to conserve than would otherwise be provided under a rate design where all of Southwest's fixed cost of service are recovered through a monthly basic service charge. (Gieseking Rejoinder Testimony, pp. 8-9 and Tr. p. 417.)

RUCO acknowledges that Southwest experienced significant declining residential use per customer; RUCO presented no evidence suggesting that this decline in use will cease; RUCO supports an increase in DSM program funding; RUCO acknowledges that the decline in use impacts Southwest's ability to earn its authorized rate of return; RUCO acknowledges that their rate design proposal assumes there will be no further decline in usage and offers no relief to Southwest if there is a decline in usage; and RUCO acknowledges that Southwest faces a significant disincentive to promote conservation when its margin recovery is directly related to the volume of gas sold. (Tr. pp. 970, 989-91, 1018, and 1048.) Yet, RUCO opposed the CMT, never suggested modifications to the CMT, never proposed its own decoupling mechanism, and does not otherwise sufficiently reduce the Company's dependency upon gas sales to recover its authorized margin. As such, RUCO failed to present evidence raising a serious doubt as to the prudence of the CMT, and has likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). Especially, since Southwest is willing to modify the CMT to address any concerns that RUCO has raised that the Commission deems valid and well founded in fact or law.

Accordingly, an order approving the CMT or some other decoupling mechanism is warranted.

(b) *Staff.*

Staff also failed to present sound justification for its opposition to the CMT. With regard to Staff's testimony on this issue, it is important to separate the unfounded and unsupported hyperbole and rhetoric from verifiable evidence. Staff's testimony is diluted with how drastic, unprecedented, and inequitable the CMT is. (Musgrove Direct Testimony, p. 9-10; Musgrove Surrebuttal Testimony, p. 89.) However, notwithstanding the rhetoric and hyperbole, the record is devoid of any verifiable evidence to support Staff's contentions.

To the contrary, the record contains evidence suggesting that the CMT is very similar to Southwest's existing PGA mechanism, in that both the CMT and the PGA protect Southwest and its customers against changes in market conditions that are beyond Southwest's control. Furthermore, contrary to Staff's assertions, decoupling mechanisms are not drastic and unprecedented among state public utility regulatory commissions, including this Commission.

(Exhibits A-53 and Appendix 1 attached hereto.)[1] As exemplified by Exhibits A-53 and Appendix 1, decoupling is not as unprecedented, revolutionary, or unknown as Staff contends. As requested by the Judge during the hearing, Exhibit A-53 are copies of state regulatory commission orders that Southwest is aware of that have either approved or rejected some form of decoupling mechanism for natural gas utilities. Furthermore, attached hereto as Appendix 1 is a list of state public utility commission decisions that addressed decoupling, both electric and gas. In fact, in Appendix 1, there is a 1991 Arizona Corporation Commission Decision on resource planning (for electric utilities) wherein, among other things, the Commission deferred to future rate cases the issue of decoupling sales from profitability and whether lost net revenues from DSM programs are recoverable. (Commission Decision No. 57589, 128 P.U.R.4th 448, 1981 WL 137969 (Ariz. C.C. 1981).)

Staff's arguments against the CMT similar to RUCO's arguments, to wit, the residential class should not be singled out and customers would be required to pay for the full margin authorized by the Commission. (Musgrove Direct Testimony, p. 7.) For the same reasons noted above, Staff's arguments on these two points are also unsupported and must fail. In fact, Staff acknowledges that it is legitimate for Southwest to recover the full margin authorized by the Commission and to do so would require that the customers pay the full margin. (Tr. p. 1202.) Something, the CMT is designed to accomplish.

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[1] Exhibit A-53 is a late filed exhibit that contains a copy of each state public utility regulatory commission decision that was available to Southwest and that addressed some form of decoupling mechanism for natural gas utilities, and their corresponding tariff sheets. Appendix 1 is a list of state public utility commission decisions that have addressed decoupling and decoupling mechanisms, for both electric and gas utilities. Judge Nodes requested copies of all commission orders that have dealt with decoupling and requested that Southwest include them with its closing brief. (Tr. p. 403.) Due to the large number of cases listed in Appendix 1, Southwest is only including the citations to those cases and will supplement Exhibit A-53 with additional commission orders that pertain to gas utilities as it receives them.

Staff further argues that the circumstances in Arizona are different than in those jurisdictions that have approved a decoupling mechanism, i.e. California, Oregon, and Maryland. However, the circumstances and the mechanisms are really not that different. (Musgrove Direct Testimony, p. 10.) For instance, Baltimore Gas & Electric's ("BG&E") (Mr. Musgrove's former employer) decoupling mechanism tracks usage on a margin per customer basis and does not apply to all customer classes, similar to the proposed CMT. (Exhibit A-53.) However, BG&E's mechanism is slightly different from the proposed CMT in that it makes adjustments monthly instead of yearly, and it applies to the residential and general service customer classes instead of the residential class only. (*Id.*)

The Company's California decoupling mechanism tracks 100% of the dollar difference between the authorized margin in the general rate case and the actual margin billed, which is similar to the proposed CMT. (Exhibit A-53.) Furthermore, California has had some form of decoupling, applicable to all of its major utilities, for almost thirty years, which is also contrary to Staff's argument that Southwest's proposal is a drastic and unprecedented change.

With regard to Northwest Natural's decoupling mechanism, it has a one year deferral for recovery of the uncollected authorized margin, tracks customer usage on a per customer basis, and it does not apply to all customer classes, all of which are similar to the proposed CMT. (Exhibit A-53.) Unlike the proposed CMT, the Northwest Natural mechanism does apply to Northwest Natural's residential and commercial customer classes and does not apply to weather related changes in usage. (*Id.*) However, Northwest Natural has a separate mechanism that tracks the vagaries of weather and protects the company and customers during warmer and colder than normal winters; but, each customer has the option to opt-out of the weather tracking mechanism so that the customer and the company equally bear the risk associated with the vagaries of weather. (*Id.*) Furthermore, in a recent study performed by Christensen Associates Energy Consulting, LLC pursuant to the Oregon Public Utilities Commission's decision granting the decoupling mechanism, the consulting firm suggested adopting full decoupling and eliminating the distinction between weather and non-weather related reductions in consumption. (Exhibit S-23, Christensen Associates Energy Consulting, LLC, <u>A Review of Distribution Margin Normalization as Approved by the Oregon Public Utility Commission for Northwest Natural</u>, by Daniel G. Hansen and Steven D. Braithwait, March 31, 2005.) The Company's CMT proposal essentially combines Northwest Natural's two mechanisms into a full decoupling mechanism, as recommended in the study.

Staff acknowledges that Southwest has experienced significant declining residential use per customer; Staff presented no evidence suggesting that this decline in use will cease; Staff supports an increase in DSM program funding; Staff acknowledges that the decline in use has impacted Southwest's ability to earn its authorized rate of return; Staff acknowledges that their rate design proposal assumes there will be no further decline in usage and offers no relief to Southwest if there is a decline in usage; and Staff acknowledges that Southwest faces a significant disincentive to promote conservation when its margin recovery is directly related to the volume of gas sold. (Tr. pp. 1134, 1122, 1169-70, 1201, 1230, and 1273-75.) Yet, Staff opposed the CMT, never suggested modifications to the CMT, and never proposed its own decoupling mechanism, and does not otherwise sufficiently address reducing the Company's dependency upon gas sales to recover its authorized margin.

As such, Staff has failed to present evidence raising a serious doubt as to the prudence of the CMT, and has likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). Especially since Southwest is willing to modify the CMT to address any concerns that Staff has raised that the Commission deems valid and well founded in fact or law.

As such, an order approving the CMT or some other decoupling mechanism is warranted.

(c) *SWEEP/NRDC.*

Unlike RUCO and Staff, SWEEP/NRDC did make an ostensible inquiry regarding the CMT. (Schlegel Direct Testimony, p. 8.) Unfortunately, when Southwest responded to those inquiries, SWEEP/NRDC never responded or followed up with further inquiries, and never disputed the Company's responses. (Fetter Rebuttal Testimony, pp. 9-10.) It was not until the time of the hearing that SWEEP/NRDC witness Jeff Schlegel further attempted to clarify SWEEP/NRDC's purported concerns about the CMT when he identified four specific concerns. (Tr. p. 1053-55.) At the hearing, Mr. Schlegel, while expressing his clear support for decoupling mechanisms and the concept of decoupling margin recovery from gas sales, claimed that he could not support the CMT because he believed the Company could better balance the customers' interest with the Company's interests by: (1) keeping the risk associated with the vagaries of weather with the Company; (2) by adjusting the risk adjusted rate of return to reflect a more certain revenue stream; (3) by applying the CMT to all customer classes; and (4) by better managing the magnitude of the costs associated with the CMT, i.e. through either an agreement regarding frequency of filing subsequent rate cases or by imposing a cap or a range on the amount of the decoupling account. (Tr. pp. 1053-1055.) Mr. Schlegel further stated that until those issues are addressed, he could not support the proposed CMT. (Tr. p. 1053.)

Oddly enough, this opposition was in spite of SWEEP/NRDC's pronounced support for the concept of decoupling in other proceedings and jurisdictions, and SWEEP's clear support for a similar, if not identical, type of decoupling mechanism in Southwest's Nevada general rate case. (Tr. pp. 1058-62 and Exhibit No. A-48.) When Mr. Schlegel was asked to further explain his concerns and how they were applicable to the CMT, he contradicted himself by recognizing that the positive characteristics of the CMT were: (1) that it does take into account weather by capping the Company's over-recovery due to colder than normal weather; (2) that Southwest has expressed a willingness to apply the CMT to all customer classes; and (3) that the Company has presented a risk adjusted rate of return. (Tr. pp. 1057-1058.)

Thus, despite Mr. Schlegel's contradictory remarks regarding his concerns and the positive attributes of the CMT, the only concern he raised that was not addressed at the hearing is the management of the CMT by agreeing to a certain frequency of filing rate cases or by permitting Commission review if the decoupling account becomes too large. (*Id.*) However, any interested person can request that the Commission, on its own motion, investigate the rates and charges of the Company, and the Commission can include in its order a cap on the CMT adjustment account or mandate that Southwest come back for another rate case after the passage of a specified period of time. (ARS 40-246.A.) As such, SWEEP/NRDC's concern regarding the magnitude of the cost is completely negated. Nevertheless, to the extent that the Commission wants further protections, Southwest is willing to agree to a frequency of filing rate cases or agree to file reports with the Commission regarding the size of the CMT adjustment account to address the concerns expressed by SWEEP/NRDC.

Accordingly, similar to RUCO and Staff, while the Company recognizes SWEEP/NRDC's ostensible attempt to exchange ideas regarding the CMT, albeit somewhat inconsistent and contradictory, SWEEP/NRDC also failed to present evidence raising a serious doubt as to the prudence of the CMT, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). Especially in light of the Company's willingness to modify the CMT to address any concerns that the Commission deems valid and well founded in fact or law.

Accordingly, in light of the testimony of RUCO, Staff, and SWEEP/NRDC, two things are clear. First, none of the Intervening Parties have presented sound justification for opposing the CMT or some other form of decoupling mechanism, especially since Southwest is willing to modify the CMT to address any well founded concerns of the Intervening Parties. Second, despite acknowledging Southwest's problems regarding volumetric rates that load margin into the volumetric charge, none of the Intervening Parties have suggested alternative decoupling mechanisms or rate design proposals that sufficiently reduces Southwest's dependency upon gas sales to recover its authorized margin. Although Southwest believes that the proposed CMT is an equitable decoupling mechanism, Southwest respectfully requests that to the extent the Commission determines modifications can be made to the CMT to better balance the interests of the Company and its customers, the Commission approve an alternative decoupling mechanism or modify the CMT, as opposed to rejecting a decoupling mechanism in its entirety.

(2) *Allocation of Margin.*

Staff and RUCO challenge Southwest's allocation of margin among its customer classes. With the exception of RUCO claiming that it maintained the relationship of residential and non-residential margin as a percentage of total margin as it presently exists, Staff and RUCO failed to explain how they determined their proposed customer class margin requirements. (Gray Surrebuttal Testimony, pp. 9-10; Diaz Cortez Direct Testimony, pp. 32-33; Congdon Direct Testimony, p. 9; and Congdon Rebuttal Testimony, p. 22.) Conversely, Southwest's proposed method of allocating margin among customer classes is based on the results of its customer class cost of service study, which Staff recommends be accepted. (Congdon Direct Testimony, p. 9; Berger Direct Testimony, pp. 1-6; and Bahl Direct Testimony, pp. 1-8.) The allocation of margin, as well as the total level of authorized margin, affects the level of commodity margin rates for each customer class because after setting the monthly basic service charge, the commodity margin rate(s) for each customer class are calculated to recover the total authorized class margin. (Congdon Direct Testimony, p. 9 and Congdon Rebuttal Testimony, p. 22.) As such, commodity margin rates will change depending upon the authorized level of margin, the allocation of margin to customer classes, and the basic service charges ultimately authorized for each customer class.

Staff and RUCO have failed to present evidence raising a serious doubt as to the prudence of the Company's proposed allocation of margin, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint positions. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). To the contrary, Southwest explains that its allocation methodology is based firmly on the results of its class cost of service study (which is unchallenged) and the allocation methodology gradually moves each class's rate of return closer to the cost of service. (Congdon Rebuttal Testimony, p. 22-24.) The allocation of each class's percentage of the total increase in margin (less the "Other Operating Revenue") is reflected in the table below:

Rate Schedule	Percentage of Authorized Increase in Margin
Single-Family Residential Gas Service	76.1085%
Multi-Family Residential Gas Service	4.6804%
Master Metered Mobile Home Park Gas Service	0.1932%
General Gas Service - Small	3.0940%
General Gas Service - Medium	5.3846%
General Gas Service - Large	7.5457%
General Gas Service - Transportation Eligible	2.2685%
Air Conditioning Gas Service	0.0431%
Street Lighting Gas Service	0.0100%
Gas Service for Compression	0.1046%
Electric Generation Gas Service	0.3092%
Small Essential Agriculture User Gas Service	0.1620%
Natural Gas Engine Gas Service	0.0000%
Optional and Special Contract	0.0959%
Other Operating Revenues	$ 1,250,597

Therefore, the Commission should adopt an order allocating the authorized margin among customer classes using the information presented above.

(3) *Residential Gas Service– Schedule G-5.*

RUCO, Staff, and Southwest have each proposed their own residential rate designs. (Congdon Direct Testimony, pp. 16-17; Gray Surrebuttal Testimony, Supplemental Schedules filed with Summary of Testimony; Moore Surrebuttal Testimony, Schedule SUR-RLM-16.)

No Intervening Party disputes that Southwest's residential rate design proposals are the most stable rate designs and that they better shield customers from colder than normal winter bills. (Tr. pp. 304, 1001, and 1231.) Furthermore, the Company's rate design proposals provide the best economic price signal to residential customers regarding the **actual market price of natural gas** because the Company's proposed volumetric charges more closely resemble the actual market price of natural gas than either Staff's or RUCO's proposals.

Rather, RUCO and Staff challenge Southwest's proposed residential rate design, with and without the CMT, because they claim the proposals move too fast towards cost of service based rates. (Tr. pp. 1250.) No other Intervening Party challenges Southwest's residential rate design proposals.

(a) *RUCO.*

RUCO, based upon its recommended revenue requirement, proposes its own residential rate design of a basic service charge of $10.09 and a volumetric rate of $.494191. (Moore Direct Testimony, p. 32.) RUCO contends that it recognizes Southwest's concerns and attempts to address them by shifting a portion of the volumetric charge to the basic service charge. (Diaz Cortez Direct Testimony, p. 37.) However, RUCO's rate design proposal does not shift enough of the volumetric charge to the fixed monthly charge and, as a result, puts Southwest at an even greater risk of not recovering its authorized margin than Southwest presently faces under its existing residential rate design. (Exhibit A-51.) Despite RUCO's own acknowledgment that the more margin you include in the volumetric charge, the more the Company is at risk to not recover its authorized margin; RUCO proposes to eliminate the declining block rate structure that exposes Southwest to the risk of not recovering $.494191 of margin for every therm of gas that it does not sell. (Exhibit A-51.) In comparison, under Southwest's existing rate structure, Southwest is at risk of not recovering $.40344 (second block rate) of margin for therms it does not sell. (*Id.*) Consequently, Southwest is in a worse position under RUCO's rate design proposal than its current rate design, and is even at a greater risk if the Company continues to experience a decline in average user per customer. (*Id.*)

As such, RUCO failed to present evidence raising a serious doubt as to the prudence of the Company's residential rate design, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell,* 27 CPUC 2d 1 (1987).

. Furthermore, contrary to RUCO's claim that a flat commodity rate provides a better price signal, RUCO's proposed rate design actually distorts the price per therm of natural gas more than any other proposed rate design. (Exhibit A-51.) Actually, the best price signal is the marginal cost of producing the last unit of the commodity in question. (Kahn, Alfred E., The Economics of Regulation, pp. 65-70 (Massachusetts Institute of Technology 1990) (1970-71)). Since Southwest's costs are largely fixed and do not vary with the amount of gas consumed, the marginal cost of natural is the purchased cost of gas. (Congdon Rebuttal Testimony, pp. 3-22.) As such, contrary to RUCO's assertion, Southwest's proposed residential rates actually provide the best **economic price signal** because they better reflect the marginal cost of the natural gas commodity. (*Id.* and Kahn, Alfred E., The Economics of Regulation, pp. 65-70 (Massachusetts Institute of Technology 1990) (1970-71))

Moreover, the record is full of dialogue regarding price signals and conservation. While distorting the price per therm by loading margin on top of the cost of gas may be effective <u>for the</u>

limited purpose of forcing customers to use less gas, the consequences of such a pricing scheme will result in consumers making inefficient energy decisions because their decisions will not be based upon an accurate measure of the marginal cost of natural gas, but rather, some inaccurate and distorted price. (Congdon Rebuttal Testimony, pp. 3-22.) Also, this type of proposal, without a decoupling mechanism, would be damaging to the Company because of the increased risk of not recovering its authorized margin. Accordingly, Southwest's proposed rate design is a better rate design alternative because it more closely approximates the actual market price of natural gas, i.e. the marginal cost of natural gas itself. Furthermore, the premise of conservation is to conserve the natural resource, not to minimize customer use at the expense of the Company by moving more margin to the volumetric charge and putting the Company at greater risk of not recovering its authorized margin.

(b) *Staff.*

Staff, based upon its recommended revenue requirement, recommends a basic service charge of $9.70, a first tier block rate of $.54200 for the first 15 therms in the summer and the first 35 therms in the winter, and a second tier rate of $.50100.

In addition to acknowledging the validity the reasons behind Southwest's rate design proposals, i.e. margin recovery and reducing the impact of weather variations, Staff also acknowledges that **Southwest's rate design is the most stable rate design** being proposed. (Gray Surrebuttal Testimony, p. 9.) The rate stability feature of Southwest's rate design proposal is even more important in light of the need for more stable rates in a climate of rapidly increasing natural gas prices due to the recent hurricanes in the gulf coast region and natural gas fired electric generation. (Congdon Rebuttal Testimony, pp. 15-21.)

Notwithstanding Staff's recognition of the positive characteristics of Southwest's rate design proposals, Staff still challenges the Company's rate design proposals on several grounds, including, that it moves too rapidly towards cost of service based rates, it negatively impacts low-volume customers, does not provide an accurate price signal because declining block rates may provide a disincentive to conserve, and because a declining block rate schedule may be too complicated for customers to understand and to administer.

Staff's claim that the Company's rate design moves too rapidly towards cost of service based rates is based on the fact that Southwest's proposal results in larger percentage increases for low usage residential customers. Southwest does not dispute that its proposed rate design results in a modest dollar increase for low-volume residential customers. In fact, Southwest has presented extensive evidence showing that its rate design results in monthly bills for low-volume customers that are from $4 to $8 higher than Staff's or RUCO's proposals. (Congdon Rejoinder Testimony, p. 4 and Congdon Rejoinder Testimony, Exhibit ABC-1.) However, Southwest also presented an equal amount of evidence showing that its proposal results in $13 to over $30 per month savings for large-volume residential customers, as compared to Staff's and RUCO's proposed rate designs. (*Id.*) Southwest contends that low-volume residential customers are more able to afford $4 to $8 per month increases than large-volume customers being able to afford $13 to over $30 increases, increases they would be subjected to under Staff's and RUCO's rate designs. (Congdon Rejoinder Testimony, p. 5.)

Southwest has also presented evidence demonstrating that large-volume residential customers will provide a subsidy to low-volume customers under the various Intervening Parties proposed rate designs. (Congdon Rebuttal Testimony, Exhibit No. ABC-3). Southwest's proposed rate design reduces existing intra-class rate subsidies by moving residential rates gradually closer to Southwest's cost of providing service.

Contrary to Staff's concerns regarding the impact on low-income customers, Southwest's rate design proposal actually reduces the intra-class subsidy that large-volume residential customers, including, low-income customers (the class that likely needs the greatest assistance), currently provide low-volume residential customers. (Tr. p. 1217 and Exhibit A-50.) Staff's concern for low-volume customers would make some sense if low-income customers were primarily low-volume customers. However, Exhibit A-50 clearly demonstrates <u>low-income customers cannot be equated with low-volume customers</u>. Not only does Staff's proposal require larger dollar increases for low-income/high-volume customers, but Staff's proposals (as well as RUCO's) actually penalize the low-income customer that has high usage due to their inability to pay for efficiency improvements. Whereas, Southwest's proposals more evenly distribute the increased costs among low-income customers regardless of the volume of gas they consume.

Also, contrary to Staff's argument that declining block rates do not provide the most accurate price signal, the best price signal is the marginal cost of the commodity in question. (Kahn, Alfred E., The Economics of Regulation, pp. 65-70 (Massachusetts Institute of Technology 1990) (1970-71)). As such, Southwest's rate design, which has a second tier rate that more closely approximates the marginal cost of natural gas, provides the best **economic price signal** among the proposed rate designs. (*Id.*) However, the best economic price signal is achieved through a combination of changes to residential rate design as proposed by Southwest, coupled with changes to Southwest's PGA mechanism to allow the monthly cost of gas included in sales rates to more closely follow current market prices for natural gas. (*Id.*)

Staff's assertions that declining block rates may provide a disincentive to conserve and that declining block rates may be too complicated for customers to understand and to administer are fundamentally flawed. Staff's argument that declining blocks may provide a disincentive to customers to conserve is not practical. (Gray Direct Testimony, p. 35.) Customers do not have the ability to easily monitor their daily or weekly gas use to determine how many therms they have consumed in any particular day, week, or month, and how close they are to approaching the second tier rate. As such, the premise that customers are induced to use more gas as they approach the second tier rate is unfounded because customers do not readily have available to them a means to know when they are approaching the second tier rate. Staff also argues that declining block rates are too complicated for customers to understand their bills. (Gray Direct Testimony, p. 34.) These arguments are simply inconsistent and not logical. Staff on one hand argues that declining blocks may discourage conservation because customers are too sophisticated and understand when they are approaching the second tier rate, thus possibly discouraging conservation. Yet, Staff on the other hand, argues that customers are confused about declining blocks (even though Arizona's largest electric utility has a blocked residential rate design) and they do not understand their bills. This demonstrates the unfounded nature in the concerns raised by Staff regarding the continued use of declining block rates.

Staff failed to present sufficient evidence raising a serious doubt as to the prudence of the Company's residential rate design, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809

(D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). As such, an order approving the Company's rate design proposal is warranted.

(c) *SWEEP/NRDC*.

Unlike Staff and RUCO, SWEEP/NRDC does not sponsor a particular rate design. Nevertheless, SWEEP/NRDC supports decoupling authorized margin recovery from gas sales, while opposing higher basic service charges and the concept of a flat rate structure. (Schlegel Direct Testimony, pp. 4-5.) The primary reason that SWEEP/NRDC gives for opposing higher fixed charges is that the price signal is muted, and the primary reason for supporting a flat rate structure is that customers are encouraged to conserve. (Schlegel Direct Testimony, pp. 4-5; Tr. p. 1040-1042.) However, as previously discussed, the failure to price gas at the actual cost of service only distorts the price by loading margin on top of the gas cost for the purpose of forcing customers to use less gas. This is a flawed goal, in that the actual and most economically efficient use of the natural gas occurs when the price is a reflection of the marginal cost of gas. (*Id.* And Kahn, Alfred E., The Economics of Regulation, pp. 65-70 (Massachusetts Institute of Technology 19909) (1970-71)) Both the flat rate structure and lower fixed charges have the effect of distorting the actual price of gas. As such, RUCO failed to present any evidence raising a reasonable doubt about the Company's residential rate design proposal and failed to present sufficient evidence demonstrating the reasonableness of their counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987).

(4) *Multi-Family Residential Gas Service – Schedule G-6.*[2]

Only Staff challenges Southwest's proposed multi-family rate schedule. (Gray Direct Testimony, p. 35.) However, Staff admittedly does not strongly challenge the creation of a multi-family residential class, but contends that Southwest has not presented a "compelling reason" to do so. (Gray Surrebuttal Testimony, p. 10.)

First, Southwest's burden <u>is not</u> to demonstrate a "compelling reason" to successfully support a modification to its tariff. Rather, once an opponent to a general rate case makes a showing of improvidence, the burden of persuasion, not merely of producing rebuttal evidence falls squarely on the utility to show that the requested relief **is reasonable**. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987).

Second, Staff failed to present evidence raising a serious doubt as to the prudence of the Company's multi-family schedule. (Gray Direct Testimony, p. 35 and Gray Surrebuttal Testimony, p. 10; see also, *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). To the contrary, Southwest presented a substantial amount of evidence supporting the reasonableness of its request for a proposed multi-family residential rate schedule by explaining that multi-family customers use significantly less gas than Southwest's single-family residential customers, and by creating a distinct rate schedule for this class of customers allows the Commission to moderate the affect on Southwest's smallest residential customer class as it moves residential service rates gradually towards the cost of

[2] RUCO accepts Southwest's proposal. (Diaz Cortez Direct Testimony, p. 9.)

service. (Brooks Rebuttal Testimony, pp. 26-27.) As such, contrary to Staff's assertions, Southwest's proposed multi-family residential class rate schedule is reasonable and an order approving this rate schedule is justified.

(5) *Low-Income Residential Gas Service – Schedule G-10.*[3]

Once again, only Staff challenges Southwest's proposal regarding the low-income residential gas schedule. (Gray Direct Testimony, p. 36.) Staff has failed to present sufficient evidence raising a serious doubt as to the prudence of the Company's low-income proposal, and has likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell,* 27 CPUC 2d 1 (1987).

To the contrary, Southwest has presented a substantial amount of evidence demonstrating the reasonableness of its proposal by explaining how the elimination of the tariff and the utilization of a year-round discount better protects low income users because Southwest's proposed residential rate design shifts a portion of the margin recovery away from the winter season into the summer season, thus reducing the impact of high winter bills by spreading the protection to low-income customers year round. (Congdon Rebuttal Testimony, p. 27-29.) In fact, Southwest's rate design proposal better protects low income users than the other rate design proposals because it reduces the impact of potential high winter bills. (*Id.* and Congdon Rejoinder Testimony, p. 5.) Moreover, Southwest's proposal to eliminate the low-income rate schedule and incorporate the low-income discount provisions into its proposed single and multi-

[3] RUCO accepts Southwest's proposal and ACAA is willing to accept the Company's proposal as long as it proves to be the most beneficial to low-income customers. (Diaz Cortez Direct Testimony, p. 9 and Tr. p. 522.)

family residential rate schedules should not be interpreted as a reduced commitment on Southwest's part to its low-income customers. Southwest is committed to continue its efforts to actively promote the low-income customer benefits, i.e. whatever discounts the Commission ultimately authorizes, that are available to qualified customers whether low-income service is provided under discount provisions included in Southwest's proposed single and multi-family residential rate schedules, or under a separate low-income rate schedule.

As such, contrary to Staff's assertions, Southwest's proposal to incorporate low-income discount provisions into its proposed single and multi-family residential rate schedules and to extend a year-round low-income discount for low-income residential gas service are reasonable and an order approving this rate schedule is justified.

(6) *Special Residential Gas Service for Air Conditioning – Schedule G-15.*

Staff challenges Southwest's recommendation to eliminate this schedule and recommends keeping the G-15 tariff with the same rates, with the summer second block rate increased to $.28 per therm. (Gray Direct Testimony, p. 41.) Staff failed to present any evidence raising a serious doubt as to the prudence of the Company's proposal regarding Schedule G-15. As such, Staff's proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987).

To the contrary, Southwest presented sufficient evidence demonstrating the reasonableness of its proposal by explaining that the differential between the currently effective G-15 rate and Southwest's proposed second block margin rate is very small, and the elimination of this schedule will correspondingly eliminate the need to administer a schedule with a relatively small number of customers. (Congdon Rebuttal Testimony, pp. 29-30 and Application, Schedule H-2, Sheet 1.) However, as noted by Mr. Congdon, if the Commission does not approve one of the Company's residential rate design proposals, this schedule should be retained and the summer air conditioning rate (or the second tier rate) should be set at rate consistent with the Company's proposed allocation of margin for customer classes. (Congdon Rebuttal Testimony, p. 29.)

(7) *Master Metered Mobile Home Park Gas Service – Schedule G-20.*

Only Staff challenges Southwest's proposal to increase the basic service charge to $100 and to increase the per therm rate to $.32271, while Staff recommends increasing the basic service charge to $60. (Gray Direct Testimony, p. 43.) Staff failed to present any evidence raising a serious doubt as to the prudence of the Company's residential rate design. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell,* 27 CPUC 2d 1 (1987).

To the contrary, the reasonableness of Southwest's proposal is exemplified by the fact that the Company's proposal better reflects the cost of service based monthly customer charge required for this class of customers. (Application, Schedule H-6, Sheet 6.) As such, an order authorizing the increase of the basic service charge to $100 and an increase to a per therm rate that is consistent with the Company's margin allocation methodology is warranted.

(8) *General Gas Service – Schedule G-25.*[4]

Once again, only Staff challenges the modification to the sub classes within the general

[4] RUCO accepts Southwest's proposal to modify the sub classes within the commercial class of customers. (Diaz Cortez Direct Testimony, p. 9.)

service class of customers, including the creation of a smaller sub class for those who use less than 600 therms per year. (Gray Direct Testimony, p. 43.) Southwest proposed the following basic service charges: \$25 – Small; \$35 – Medium; \$150 – Large; and \$750 – Transport Eligible; whereas, Staff and RUCO proposed their own respective basic service charges. (Congdon Rebuttal Testimony, p. 31.) Southwest also proposes to revise the billing demand calculation for general service customers using more than 180,000 therms to equal customers' non-coincident peak month throughput.

Staff failed to present sufficient evidence raising a serious doubt as to the prudence of the Company's proposals regarding Schedule G-25, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). To the contrary, Southwest presented sufficient evidence demonstrating the reasonableness of its proposal by explaining that the proposed charges better reflect the cost of service and are more gradual than RUCO's, and that Southwest's proposed billing demand calculation stabilizes revenues and more fairly reflects the value to customers of Southwest's service on an annual basis. (Congdon Rebuttal Testimony, pp. 30-33 and Congdon Rejoinder Testimony, p. 15.) Furthermore, the DOD also proposes a billing demand equal to a customers maximum throughput during a defined six month winter season. (Neidlinger Surrebuttal Testimony, p. 3.)

As such, an order authorizing the creation of a smaller sub class for those customers who use less than 600 therms per year; authorizing the Company to charge the following basic service charges of \$25 – Small; \$35 – Medium; \$150 – Large; and \$750 – Transport Eligible; and approving a billing demand equal to a customers maximum non-coincident peak month throughput is warranted.

(9) *Air Conditioning Gas Service – Schedule G-40.*

Only Staff challenges Southwest's proposal to charge this class of customers a basic service charge of $25. (Congdon Direct Testimony, p. 14 and Application, Schedule H-3.) Staff recommends that the basic service charge remain at the otherwise applicable tariff rate. (Gray Direct Testimony, p. 48.) Staff failed to present any evidence raising a serious doubt as to the prudence of the Company's proposal regarding Schedule G-40. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). As such, an order authorizing the Company to charge this class of customers a basic service charge of $25 is justified.

(10) *Gas Service for Compression on Customer's Premises – Schedule G-55.*

Only Staff challenges Southwest's proposal to increase the basic service charge to $12, $25, and $350, for residential customers, small customers, and large customers, respectively, and to increase the per therm rate to a per therm rate that is consistent with Southwest's proposed methodology for allocating margin to customer classes. (Application, Schedule H-3, Sheet 3 and Congdon Direct Testimony, pp. 9-12.) Based upon Staff's proposed revenue requirement, it recommends basic service charges of $9.70, $24, and $185, for residential customers, small customers, and large customers, respectively, and to increase the per therm rate to $.165. (Gray Direct Testimony, p. 49.)

Staff failed to present any evidence raising a serious doubt as to the prudence of the

Company's proposal regarding Schedule G-55, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987).

To the contrary, Southwest has presented sufficient evidence demonstrating the reasonableness of its proposal because the proposal better reflects the Company's cost to serve this class of customers. (Application Schedule H-6, Sheet 7.) As such, an order authorizing an increase in the basic service charges to $12 (or the basic service charge for the residential class that is ultimately approved in this proceeding), $25, and $350, for residential customers, small customers, and large customers, respectively, and to increase the per therm rate to a rate consistent with Southwest's proposed methodology for allocating margin to customer classes is warranted.

(11) ***Cogeneration Gas Service – Schedule G-60.***

Southwest challenges Staff's request to increase the per therm rate to $.11 because Staff's proposed rate does not reflect Southwest's proposed basic service charges and is not based on Southwest's proposed allocation of margin to customer classes. (Congdon Direct Testimony, p. 12.) Staff failed to present any evidence raising a serious doubt as to the prudence of the Company's proposal regarding Schedule G-60, and likewise 1failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC

2d 1 (1987).

To the contrary, Southwest presented sufficient evidence demonstrating the reasonableness of its proposal by fully supporting its proposed basic service charges and explaining that the per therm rate should be established using Southwest's proposed allocation of margin among customer classes because Southwest's methodology better reflects the cost of service for each class of customers. (Congdon Direct Testimony, p. 12.) As such, an order authorizing a per therm rate using the Company's proposed basic service charges and its proposed allocation of margin among customer classes is proper.

(12) Small Essential Agricultural User Gas Service – Schedule G-75.

Only Staff challenges Southwest's proposal to reclassify customers whose bills would be reduced to general service rate schedules and to close this schedule to new service. (Gray Direct Testimony, pp. 52-53.) Staff recommends retaining this schedule absent some "powerful reason," and allowing customers whose annual cost would be reduced to elect to switch to Southwest's general service rate schedules sometime after this rate case. (Gray Direct Testimony, p. 52.) Staff also challenges Southwest's proposed basic service charge of $150 per month and proposes instead that the basic service charge be increased from $75 to $90 per month. (Gray Direct Testimony, p. 52.)

Staff failed to present any evidence raising a serious doubt as to the prudence of the Company's proposal regarding Schedule G-75, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1

(1987). Furthermore, suggesting that customers be allowed to switch to a lower cost rate schedule after the conclusion of the rate case, without building that effect into rates, is tantamount to a taking of private property for public use in violation of the due process clause and the prohibitions in the Fifth and Fourteenth Amendments to the United States Constitution, as well as other legal principles. See *Scates v. Arizona Corporation Commission,* 118 Ariz. 531, 578 P.2d 612 (1978)

Southwest's proposal to reclassify customers served on Schedule G-75 is also consistent with Decision No. 58377 where the Commission suggested that the Company move customers whose annual cost of service would be reduced from this schedule to the general service schedule, and to gradually eliminate Schedule G-75. (Decision No. 58377.) Southwest proposed to reclassify 76 customers, whose annual cost of service would be reduced, from Schedule G-75 to its general service rate schedules, leaving only 36 customers remaining on Schedule G-75. (Application Schedule H-6, Sheet 7.) As part of the continued effort to eliminate this rate schedule, Southwest also proposes to close Schedule G-75 to new customers. (Congdon Rebuttal Testimony, p. 35.)

Southwest has presented sufficient evidence demonstrating the reasonableness of its proposal to reclassify customers and to move forward to eliminate Schedule G-75, as well as providing support for its proposed basic service charge of $150. (Application Schedule H-6, Sheet 7). Schedule H-4, Sheet 10 of Southwest's application shows that the impact to customers of Southwest's proposed Schedule G-75 rate design is not unacceptable. As such, an order authorizing the Company to reclassify customers whose bills would be reduced to general service rate schedules and incorporate that effect into the development of rates in this rate case, and to close this schedule to new service is proper.

(13) *Natural Gas Engine Gas Service – Schedule G-80.*

Only Staff challenges Southwest's proposal to not assign an increase in margin to this rate class (RUCO proposes a decrease in margin for this class of approximately $100,000), and to increase the off-peak basic service charge to $100, with a corresponding reduction to the commodity rate. (Application, Schedule H-3, Sheet 3 and Gray Direct Testimony, p. 53.) Staff recommends an increase in margin of approximately $354,000, an off-peak basic service charge of $0 and an on-peak basic service charge increase to $95, and a corresponding per therm rate increase. (Gray Direct Testimony, p. 53.)

Staff and RUCO failed to present any evidence raising a serious doubt as to the prudence of the Company's proposal regarding Schedule G-80, and likewise failed to present sufficient evidence demonstrating the reasonableness of their counterpoint position. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). To the contrary, Southwest presented sufficient evidence demonstrating the reasonableness of its proposal by explaining this class of customers is a very price sensitive market and as of October 1, 2005 Southwest increased this class of customers rates by 27% due to the seasonal change in gas costs. (Congdon Rebuttal Testimony, pp. 36-38.) Thus it is reasonable to expect that Southwest will lose a portion of its current Schedule G-80 market in response to price competition. Assigning additional margin to this class, as proposed by Staff, will further exacerbate cost issues customers and Southwest are both facing. (*Id.*) As such, an order rejecting Staff's proposal and accepting Southwest's proposal is warranted.

iii) Tariffs and Other Miscellaneous Issues.

(1) *Billing Determinants.*

Only RUCO challenges the Company's proposed billing determinants. (Tr. p. 924.) As explained by Mr. Congdon, RUCO committed several errors in its attempt to recalculate the billing determinants, including, without limitation, the calculation of average test year cost of gas; the incorrect pricing of bills and volumes for Southwest's former Black Mountain Gas Company customers; and the improper pricing of gas cost and basic service charge revenue applicable to Schedule Nos. G-60 and G-80, and the continued misapplication of bill frequency data. (Congdon Rejoinder Testimony, p. 9-13.) However, RUCO claims that it changed its calculation and revised its work papers after Mr. Congdon identified these errors, and so the miscalculations and errors highlighted in Mr. Congdon's rejoinder testimony are not proper. (Tr. p. 241.)

While Southwest acknowledges that Mr. Moore may (or may not) have made changes to his work papers, they were never provided to Southwest. (Tr. p. 268.) Also, regardless of any changes Mr. Moore may (or may not) have made, his calculations are still incorrect because in his surrebuttal testimony he provided corrections that continued to reflect overstated bills and volumes. (Moore Surrebuttal Testimony, Schedule RLM-16.) As such, Mr. Moore has overstated the total margin that his bills and volumes will purportedly collect, which is margin the Company will not realize if Mr. Moore's bills and volumes are adopted by the Commission.

Furthermore, Staff did not challenge the billing determinants and agrees with the billing determinants presented by the Company in its Application. Since the Company identified numerous errors in RUCO's attempt to recalculate the billing determinants and meticulously supported its proposed test period bills and volumes, it is more likely than not that Staff and Southwest are correct regarding the calculations of the billing determinants that are proposed by Southwest. (Congdon Direct Testimony, p. 3.) As such an order approving the billing determinants provided by the Company is warranted.

(2) *Purchased Gas Adjustor.*

Southwest did not propose any change to the PGA bank balance trigger in its Application. However, Staff proposes to increase the bank balance trigger from $22.4 million to $29.2 million, and to require an officer of the company to certify that the Company's monthly PGA report is true and correct to the best of their knowledge. (Gray Direct Testimony, pp. 21 and 24-25.)

Staff failed to present sufficient evidence to support its request to adjust the bank balance trigger level of the PGA mechanism from $22.4 million to $29.2 and presented no evidence to support its recommendation to have an officer certify the PGA reports. (Gray Direct Testimony, pp. 21 and 24-25 and Gray Surrebuttal Testimony, p. 5); see also, *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). Other than its recommendation, Staff has failed to present any evidence in this proceeding supporting its request to have an officer certify the PGA reports. (Gray Direct Testimony, pp. 21 and 24-25 and Gray Surrebuttal Testimony, p. 5) Moreover, as explained by Company witness Bill Moody, Southwest shares Staff's concern about providing accurate information, but simply does not believe officer certification is necessary. (Tr. p. 454.) Rather, Southwest contends that the better person is the person closest to the production of the reports and those who testified to in the hearings. (Tr. p. 454.)

While Southwest is not necessarily opposed to increasing the PGA bank balance trigger level, Southwest does submit that to the extent the bank balance trigger level is increased, the band should also be increased. (Gieseking Rejoinder Testimony, pp. 10-11.) As explained by Mr. Congdon, by increasing the bank balance trigger level it potentially increases the amount of money carried in the balancing account and increases Southwest's business risk, and the financial community may view this proposal as yet another example of increased risk of doing business with Southwest. (Congdon Rebuttal Testimony, p. 40.)

Accordingly, Southwest suggests that if the Commission is inclined to increase the bank balance trigger level, a balanced and equitable approach would be a corresponding increase to the cap on the PGA adjustment rate to $.20 per therm. (Gieseking Rejoinder Testimony, pp. 10-11.) Furthermore, an increase to the cap will save Arizona customers in the long-run by minimizing deferrals to the balancing account, reducing the carrying costs or interest costs to customers on the PGA balance, and result in less charges to customers in a future period. (Congdon Rebuttal Testimony, p. 40 and Gieseking Rejoinder Testimony, p. 11.)

Moreover, given the recent changes in the gas market, including the effects of the hurricanes in the gulf coast region, it appears that natural gas prices will remain at elevated levels for a considerable period of time. (Gieseking Rejoinder Testimony, pp. 10-11.) Consequently, leaving the current band of $.10 in place will hinder the adjustment of gas rates that are used to reflect the calculated 12-month average cost and it will continue to distort the true marginal cost of natural gas. (*Id.*) Also, in light of all the testimony regarding price signals to customers, it makes little sense to attempt to force conservation by loading margin into the volumetric charge and, consequently, put Southwest at greater risk of not recovering its Commission authorized margin, yet continue to shield customers from the rising market price of gas by banding the gas cost rate. Such an approach effectively results in a lose, lose situation for Southwest and its customers. The result is Southwest's financial risk is unnecessarily increased and the long-term cost to Southwest's customers, due to interest on the PGA bank balance, is also unnecessarily increased. A more just and reasonable approach would be to implement Southwest's proposed residential rate design and modify the 10 cent band on Southwest's monthly PGA to allow the gas cost component of Southwest's sales rates to more closely reflect the current market price of gas. This would achieve the intended result of providing customers an accurate price signal regarding the benefit of additional conservation and energy efficiency, yet not at the expense of the Company because the volumetric rate will not be loaded up with authorized margin, which puts the Company at risk of being unable to recover the margin.

As such, an order increasing the PGA bank balance trigger level should have a corresponding increase in the band or an elimination of the band, and an order rejecting Staff's proposal for officer certification on PGA reports is warranted.

(3) ***Interest on Customer Deposits.***

The Company initially proposed to reduce the interest rate applicable to customer deposits from six percent to three percent. (Aldridge Direct Testimony, pp. 31-32.) However, Staff, in its direct testimony, challenged Southwest's proposal to reduce the interest rate on customer deposits and proposed that the interest rate on balancing accounts (LIRA, DSM, and PGA balancing accounts) be a monthly one-year nominal Treasury constant maturity rate. (Gray Direct Testimony, pp. 22, 54, and 57.) As such, Southwest revised its original request and has suggested that a balanced and equitable approach would be to synchronize the interest rates on both the customer deposits and the balancing accounts. (Congdon Rebuttal Testimony, p. 39.)

Staff failed to present sufficient evidence raising a serious doubt as to the prudence of the Company's proposal to have the balancing accounts and the customer deposit accounts have the same interest rates, and likewise failed to present sufficient evidence demonstrating the reasonableness of its counterpoint position. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). As explained by Mr. Congdon, a balanced and equitable approach would be to synchronize the interest rates on both the customer deposits and the balancing accounts, and this will eliminate unnecessary confusion that may result from vastly different interest rates. (*Id.*)

As such, an order mandating that the customer deposit accounts and balancing accounts each carry an interest rate that reflects the monthly one-year nominal Treasury constant maturity rate is warranted.

(4) *Four Hour Service Window.*

Staff also submitted a recommendation that Southwest implement, as a standard practice, a four hour service window within six months of the date of the decision in this rate proceeding and Staff takes the position that absent a "compelling reason" why Southwest cannot adopt a four hour service window, one should be implemented. (Gray Rebuttal Testimony, p. 14.)

Staff failed to present sufficient evidence to demonstrate the reasonableness of their position. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). In fact, Mr. Gray admits that he is only aware of a small number of complaints about the lack of a standard four hour service window, but that since other utilities have it, Southwest should. (Tr. p. 1243-44.)

As explained by Company witness Christina Palacios, the company already offers several service options for its customers, including a four hour service window upon customer request; the costs to change the Company's service schedules will likely result in significant costs that are not part of the cost of service presented in this Application; and Ms. Palacios further explains that Southwest is a regional leader in its industry with regard to customer service. (Palacios Supplement to Rebuttal Testimony, pp. 1-2 and Palacios Rejoinder Testimony, pp. 3-7.) Accordingly, Staff simply failed to carry its burden on this issue and Southwest presented an overwhelming amount of evidence demonstrating that there is no need for a revision to its service options, that the costs to modify may be significant, and the costs to modify its existing service options do not justify a change when "just a few complaints" have been noted, which is very small when compared to approximately 250,000 service calls that the Company responds to each year. (Tr. p. 106-07.) As such, an order denying Staff's request is warranted.

(5) *Gas Technology Institute.*

Staff also submitted a recommendation regarding minimum funding to the GTI. (Gray Direct Testimony, pp. 2-7.)

Staff failed to present sufficient evidence in this proceeding supporting its request that Southwest provide minimum funding to GTI. See, *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987). To the contrary, even though Southwest does not have a problem with funding in general, Southwest's concern is that there be flexibility when selecting the appropriate organization to fund for specific research projects, and that one particular organization not be the sole beneficiary of a guaranteed level of funding. (Marek Rebuttal Testimony, pp. 2-6 and Tr. pp. 475-76 and 481-83.) One particular organization, may or may not always be the best choice for the particular issue that needs research. (*Id.*)

Staff simply failed to carry its burden of proof on this request; whereas, Southwest presented sufficient evidence demonstrating that there is no benefit to singling out one particular research organization and mandating that Southwest exclusively use that organization for research when that particular organization may or may not be the best choice for researching a particular issue. As such, Staff's request to fund GTI must fail and if the Commission orders that funding for research be implemented, that Southwest have the flexibility to choose the organization to which it will fund.

As such, an order denying Staff's proposal to have Southwest provide a minimum funding level to GTI is warranted.

(6) *Southwest's Bill Stock.*

Staff also submits a proposal that Southwest revise its current bill stock to eliminate references to California and Nevada, and to include a box for additional contributions to the energy share program. (Gray Direct Testimony, pp. 55-56 and 59.) However, Staff failed to present sufficient evidence in this proceeding supporting its request that the Company's bill stock be changed. As such, its proposal must fail. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy Regulatory Commission,* 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell*, 27 CPUC 2d 1 (1987).

As explained by Mr. Congdon, any change to the bill stock results in a cost that is ultimately passed on to Southwest's customers. (Congdon Rebuttal Testimony, p. 38.) Southwest is not opposed to changing the bill stock, but contends that the requested change is not supported by a cost-benefit analysis regarding the proposal and the prudency of such a proposal is unknown. Southwest challenges this request on grounds that these recommendations will result in increased costs to Southwest and Southwest's customers, and <u>those costs are not represented in the cost of service in this proceeding</u>. (Congdon Rebuttal Testimony, p. 38.) As such, an order denying Staff's proposal to change Southwest's bill stock is proper.

(7) *Demand Side Management/Energy Efficiency Programs.*

Staff, RUCO, and SWEEP/NRDC each support the Company's proposed programs; the Company's proposed funding levels of the programs (with the exception of the Low Income Energy Assistance and the Energy Star Home programs), and each party supports the use of a collaborative group to further refine the programs for submittal to the Commission for final approval on how the program will be administered. (Scott Rebuttal Testimony, pp. 1-6; Scott Rejoinder Testimony, pp. 1-4; Tr. pp. 952, 1273-77; and 1022-24.)

However, RUCO challenges the proposal to provide the Company with a performance incentive; Staff challenges the proposal to increase the funding level for the Energy Star Home program and to have the LIEC program as part of the DSM funded programs; and Staff, RUCO and SWEEP/NRDC challenge Southwest's proposal to only implement DSM programs if a decoupling mechanism is approved. (Diaz Cortez Surrebuttal Testimony, pp. 11-12; Irvine Surrebuttal Testimony, pp. 2-4 and 6-7; Musgrove Surrebuttal Testimony, p. 8; and Schlegel Surrebuttal Testimony, p. 3.)

Staff challenges SWEEP/NRDC's and the Company's proposal to increase the funding level pertaining to the Energy Star Home program and to have the LIEC program part of the DSM funding. (Irvine Surrebuttal Testimony, pp. 2-4 and 6-7.) The Company is supportive of SWEEP/NRDC's proposal to increase the funding for the Energy Star Home because it will provide greater coverage, than if the funding was left at the proposed level. (Scott Rejoinder Testimony, p. 3.) Also, the Company submits that the LIEC program should be included with the DSM programs because this is a special assistance funding program that is intended for emergency situations that may be encountered by low-income households. (Scott Rebuttal Testimony, pp. 3-4.) The proposed bill assistance funding level is relatively low, representing only ten percent of the total LIEC program funding and the bulk of the program funding is targeted at weatherization, which provides long-term energy savings, improved occupant health and safety, and low customer bills. (*Id.*) Also, including it in the DSM programs is consistent with the Commission's decision in the recent Arizona Public Service decision. (*Id.* and Docket No. E-01345A-05-0414.)

All parties recognize the significant financial disincentive that the Company has with regard to promoting DSM programs. (Tr. pp. 1048, 1122, and 1169-70.) As such, mandating that Southwest engage in DSM programs without compensating it for the losses that will surely follow, the DSM programs should not be approved without some form of decoupling mechanism in place, otherwise the rates will not permit the Company to recover its authorized cost of service and will fail to provide the Company with a reasonable opportunity to earn a just and reasonable rate of return is unjust and unreasonable, and may be violative of the due process clause as a taking or seizing of private property for public use without just compensation. *Peoples*

Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission, 711 P.2d 319 (Wash. 1985); see also, *Scates v. Arizona Corporation Commission,* 118 Ariz. 531, 578 P.2d 612 (1978). Furthermore, even with a decoupling mechanism in place, the Company should also be rewarded for the successful implementation of DSM, which is what the performance incentive is designed to do.

C. COST OF CAPITAL.

Only RUCO and Staff challenged Southwest's requested relief pertaining to cost of capital and rate of return. Southwest is requesting an 11.17% (11.42% w/o a CMT) return on equity with a 42% common equity component in the capital structure. (Tr. p. 783 and Exhibit A-54.)[5] As of June 30, 2005, Southwest's actual common equity component in the capital structure was 37%. (Wood Rejoinder Testimony, Exhibit No. TKW-1). The record as a whole establishes that Southwest's requested rate of return is fair to both customers and shareholders, and it properly reflects the risks and returns appropriate for Southwest's natural gas distribution properties in Arizona.

The 5-year [2000-2004] average common equity ratio among RUCO's proxy group was 49.85%, and the average <u>earned</u> return on common equity during that same period for the same proxy group was 11.88%. (Wood Rebuttal Testimony, Exhibit Nos. TKW-1 and TKW-4, Sheet 2). It is noteworthy that Staff recently (June 24, 2005) filed testimony in the Tucson Electric Power Company (TEP) general rate review proceeding (Docket No. E-01933A-04-0408) recommending a 10.5% return on common equity with a 40% common equity component in the

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[5] Judge Nodes requested that Southwest file a late exhibit detailing the revised rate of return in light of Mr. Hanley's revisions to his cost of common equity capital component. (Tr. p. 795.)

capital structure. (Dorf Direct Testimony, p. 17.) TEP's actual common equity component in the capital structure was 26.4% at the end of the test year in that proceeding. (*Id.* at 15).

Staff witness Stephen Hill's estimate that Southwest's cost of common equity is 9.5% and that a 40% common equity component in the capital structure is appropriate is so far out of range both with respect to the proxy groups utilized by all of the cost of capital witnesses and to Staff's own recent recommendation in the current TEP general rate case. As such, Mr. Hill's cost of capital recommendation should be given little, if any, weight in determining Southwest's cost of capital.

1) Legal Argument.

As RUCO witness William Rigsby characterized, the *Hope* and *Bluefield* test, if met, provides an investor in Southwest with a reasonable opportunity to earn a return that is commensurate with the return the investor would receive from a comparable investment. (Tr. p. 949.) As is demonstrated in more detail in this Brief, Mr. Hill's recommended cost of capital for Southwest fails the *Hope* and *Bluefield* test.

i) <u>Points and Authorities</u>.

(1) *Commission's Authority.*

The Commission has the "full power to, and shall, prescribe **just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected**, by public service corporations within the state for service rendered therein" and, although the Commission's authority to prescribe rates for public utilities is plenary, **the Commission's rate-making authority is subject to the "just and reasonable" clauses of Article 15, Section 3 of the Arizona Constitution**. (Emphasis added.) (Ariz. Const. art. 15, §3 and *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169 (2001)).

As such, when the Commission is considering the various cost of capital proposals it is bound to the just and reasonable standards set forth in Article 15, §3 of the Arizona Constitution.

(2) ***The United States Supreme Court's Decision in Bluefield.***

In addition to the standards set forth in the Arizona Constitution, the Commission is also bound by the standards set forth by the United States Supreme Court in the landmark case *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia et al,* 262 U.S. 679 (1923). In *Bluefield,* the Court held that rates which are not sufficient to yield a reasonable return on the value of the property used in public service are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility of its property, in violation of the Fourteenth Amendment of the Constitution. *Bluefield,* 262 U.S. 679, at 690. The Court further stated that a public utility is entitled to **such rates as will permit the utility to earn a return on the value of the property equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings with corresponding risks and uncertainties.** (*Id.* at 692-93.) The Court also recognized that investors take into account the result of past operations as well as present rates in determining whether they will invest, and that the regulatory commission should consider these facts when determining how to justly compensate the utility for the use of its property. (*Id.* at p. 694.)

(3) ***The United States Supreme Court's Decision in Hope.***

In a subsequent decision to *Bluefield,* the United States Supreme Court further recognized that the fixing of just and reasonable rates for utilities involves a balancing of both the investors' and the customers' interests. See *Federal Power Commission et al. v. Hope Natural Gas Co. City of Cleveland,* 320 U.S. 591 (1944). The Court in *Hope* stated as follows:

> "The investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock." (*Id.* at 603.)

As such, when considering the various cost of capital proposals, the Commission should balance the interests of ratepayers and investors while considering: whether the overall rate of return is just and reasonable; whether the rates set in this proceeding will yield a reasonable return on the value of the Company's property; and whether the rates set in this proceeding will permit the Company to earn a return equal to that of other similarly situated utilities with corresponding risks and uncertainties. *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia et al,* 262 U.S. 679 (1923); *Federal Power Commission et al. v. Hope Natural Gas Co. City of Cleveland,* 320 U.S. 591 (1944); Ariz. Const. art. 15, §3; and *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169 (2001).

ii) <u>Why an Overall Rate of Return of 9.24% is Warranted</u>.

(1) Cost of Common Equity Capital Component.

Southwest is requesting a cost of common equity capital of 11.42% or 11.17% if the CMT is approved, due to the reduced risk associated with implementing the CMT or some other decoupling mechanism. (Tr. p. 783.)

Unlike Staff's primary reliance on the Discounted Cash Flow (DCF) Model, which is also contrary to the financial literature that supports the use of multiple cost of common equity models, Southwest's proposed common equity cost rate(s) of 11.17% and 11.42%, with and without the CMT, respectively, are based upon multiple cost of common equity models, namely, the Discounted Cash Flow, Risk Premium, Capital Asset Pricing, and Comparable Earnings Models. (Hanley Direct Testimony, p. 22 and Tr. p. 679.) As explained by Mr. Hanley, the Efficient Market Hypothesis ("EMH") is based on the premise that investors are aware of all publicly-available information. (*Id.*) Accordingly, absent empirical evidence to the contrary, one must assume that investors are aware of all of these various types of cost of common equity models and that they take them all into account in arriving at their buy-sell decisions. (*Id.*) There is no evidence in this record suggesting that investors do not take into account all of the various types of cost of common equity models into account in arriving at their buy-sell decisions.

Southwest's proposed common equity cost rates are also based upon a review of two proxy groups of comparable gas distribution companies (LDCs). (Hanley Direct Testimony, p. 3 and Tr. p. 680.) A comparison of the historical financial data between Southwest and the two proxy groups of LDCs shows that Southwest has earned returns well below those of the proxy LDCs. (Hanley Direct Testimony, p. 3 and Tr. pp. 680-81.) During the seven years ending 2003, Southwest achieved an average return on actual book common equity of only 6.74% in the Arizona jurisdiction, which is far less than the 11.62% and 12.11% average ROEs of the two proxy groups of LDCs. (Hanley Direct Testimony, p. 4 and Hanley Direct Testimony, Exhibit FJH-1.) Moreover, the disparity in Southwest's earned returns on common equity when compared to the proxy groups is highlighted even more by the fact Southwest's lower common equity ratio should have earned a high rate of return due to its greater financial risk and its greater level of business risk, which is consistent with the basic tenets of finance.

The reasonableness of Southwest's proposed common equity cost rates are demonstrated by the fact Southwest's lower bond rating makes it more investment-risky than the proxy groups of LDCs, and Southwest is more business risky in comparison to the proxy groups of LDCs as evidenced by a higher, more risky, S&P assigned business profile of 3.0 versus average profiles of 1.8 and 2.0, respectively, for the two proxy groups of LDCs. (Hanley Direct Testimony, pp. 13-14; Hanley Direct Testimony, Exhibit FJH-11; and Tr. p. 680.) In addition, many of the proxy group LDCs enjoy the benefits of stabilized revenues and earnings attributable to weather normalization clauses, something Southwest is currently lacking, but that it is attempting to change with its request for approval of the CMT or some other form of decoupling margin recovery from gas sales. (Hanley Direct Testimony, p. 11.) Southwest's request is also reasonable when compared to other litigated cases during the period January 1, 2003 through June 30, 2005, where the average ROE awarded to an LDC was 10.91% relative to a common equity ratio of 47.50%. (Hanley Rebuttal Testimony, p. 41; Hanley Rebuttal Testimony, Exhibit FJH-24; and Tr. p. 682.) This further supports the need for a higher awarded ROE to Southwest because Southwest is more risky, from both a business risk and a financial risk perspective.

Staff's recommended ROE is grossly understated as confirmed by Value Line's Natural Gas Distribution Industry Investment Survey of June 17, 2005, wherein it expects an ROE of 12.5% relative to a 45.5% common equity ratio. (Hanley Rejoinder Testimony, p. 16.) Those Value Line forecasts also confirm the reasonableness of Southwest's requested ROE(s) relative to a 42% hypothetical common equity ratio. (*Id.*) Contrary to Staff's contention, the DCF model has a tendency to understate the common equity cost rates when market values exceed book values and when such market-based investors' required rates of return are applied to lower book values. (Hanley Rejoinder Testimony, p. 7.) Furthermore, both regulatory agencies (Iowa and Pennsylvania) cited by Staff for support of its primary reliance on the DCF model make adjustments to the DCF cost rate to compensate for this understatement. (Hanley Rejoinder Testimony, pp. 2-4.) Those regulatory practices and the academic literature referred to by Mr. Hanley in his rejoinder testimony highlight the fallacy of the assumptions made by Staff and RUCO in their calculations utilizing the DCF model. (Hanley Rejoinder Testimony, pp. 5-7 and Hanley Rejoinder Exhibit FJH-29).

As noted by the standards set forth by the United States Supreme Court in *Bluefield,* it is essential that Southwest's greater risk be considered when determining an appropriate common equity cost rate and the common equity ratio (which are components of the Company's overall rate of return), and therefore, the common equity cost rates of the proxy groups must be adjusted to reflect Southwest's greater investment risk. See *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia et al,* 262 U.S. 679, at 692-93 (1923). Accordingly, it is necessary that Southwest be afforded an opportunity to earn a competitive ROE relative to its requested hypothetical common equity ratio of 42% (11.42% if the requested CMT is not approved or 11.17% if it is approved).

As such, consistent with the standards set forth in the Arizona Constitution and set forth by the United States Supreme Court in *Hope* and *Bluefield,* Southwest's proposed cost of common equity capital of 11.17% and 11.42%, with and without the CMT, respectively, are reasonable and will afford Southwest the reasonable opportunity to earn a just and reasonable rate of return on common equity comparable to the rates actually being earned by other similarly situated LDCs.

(2) *Hypothetical Capital Structure.*

Southwest proposes a hypothetical capital structure of 42% common equity, 5% preferred equity, and 53% long-term debt. (Wood Direct Testimony, pp. 8-33.)

Both Staff and RUCO recommend using a hypothetical capital structure for ratemaking purposes. (Hill Direct Testimony, p. 23 and Rigsby Direct Testimony, p. 44.) However, Staff recommends a hypothetical capital structure with a common equity component of 40% versus a common equity component of 42% that is recommended by both the Company and RUCO. (Wood Direct Testimony, pp. 8-33; Hill Direct Testimony, p. 23; and Rigsby Direct Testimony, p. 44.)

The unreasonableness of Staff's proposed common equity ratio of 40% is demonstrated by the fact it has a lower common equity component than the average capital structures of its own proxy group, which had an average common equity ratio of 50.2% in 2004 and it is also contrary to the National Association of Regulatory Utility Commissioner's and the Federal Energy Regulatory Commission's pronounced support for the use of the industry average capital structure when employing a hypothetical capital structure. (Wood Rebuttal Testimony, pp. 6-8 and Wood Rebuttal Testimony, Exhibit No. TKW-2.)[6] Staff's proposal also includes short-term debt, which is contrary to the Commission's practice. (Wood Rejoinder Testimony, p. 9; Tr. p. 895; Exhibit A-42; and Commission Decision No. 57075.) As such, even if you recalculate the common equity ratio of Staff's proxy group of eleven natural gas distribution companies without

[6] The use of an average common equity ratio from Staff's Natural Gas Industry group should not be used because the sample includes companies that are in significant financial distress. (Wood Rejoinder Testimony, pp. 7-9.)

short-term debt, they had an average common equity ratio of 50.21% for 2004 and 49.77% for 2003 based on total capital, which further demonstrates the unreasonableness of Staff's proposed hypothetical capital structure. (Wood Rejoinder Testimony, p. 11 and Wood Rejoinder Testimony, Exhibit No. TKW-2.)

In comparison, the reasonableness of the Company's requested capital structure is demonstrated by the fact that it contains less common equity than the average common equity ratio of the proxy groups used by Staff and RUCO and because in developing the recommended hypothetical capital structure, Southwest considered the following: rating agency criteria for a "BBB" credit rating; the relative higher investment risk of Southwest as compared to the proxy group LDCs; the high growth environment in which Southwest operates, including the impact of declining average usage and several years of warmer-than-normal heating seasons, and their impact on the Company's financial condition; and regulatory precedent for use of a hypothetical capital structure for ratemaking by this Commission. (Wood Direct Testimony, pp. 8-33 and Wood Rebuttal Testimony, pp. 3-16.) Accordingly, the Company's requested capital structure is consistent with the standards set forth by the United States Supreme Court in *Bluefield* mandating that rates permit a utility to earn a return on the value of the property equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings with corresponding risks and uncertainties. (*Bluefield* at 692-93.)

Staff also submits a recommendation that the Company file a formal recapitalization plan. (Hill Direct Testimony, pp. 25-27.) As the proponent of this plan, Staff carries the burden of proof. *Anaheim, Riverside, Banning, Colton, and Azusa, California v. Federal Energy*

Regulatory Commission, 669 F.2d 799, 809 (D.C. Cir. 1981); see also, *Re Pacific Bell,* 27 CPUC 2d 1 (1987). However, Staff has failed to present any evidence supporting the reasonableness of its request or demonstrating that the Company is not making reasonable efforts to improve its capital structure. Nowhere in Staff's testimony does it address the primary factors that have impaired the Company's ability to improve its capital structure, despite its good faith efforts, including, without limitation, the combined negative effects from having the need to make large capital expenditures due to rapid customer growth in Arizona and the Company's inability to earn its authorized rate of return, to a certain degree due to declining average residential use per customer. (See generally, Hill Direct Testimony and Hill Rebuttal Testimony.) Moreover, the Company's commitment to improving its capital structure is further exemplified by the fact the Company has issued approximately 15.8 million shares of common stock during the time period 1994-2004, which has netted the Company approximately $313.7 million in proceeds, and the Company has not raised the common stock dividend per share since May 1994. (Wood Rebuttal Testimony, pp. 20-21.) In addition, the Company has issued trust originated preferred securities to help bolster its capital structure. (Wood Rebuttal Testimony, p. 20.)

Southwest has produced substantial evidence that: it is making significant efforts to improve its capital structure; its operating environment of high growth and low returns has been a significant hindrance to the Company's efforts to improve its capital structure; and it has taken tangible steps to improve its capital structure. Moreover, the record is devoid of any evidence that demonstrates that the filing of a formal re-capitalization plan with the Commission will positively impact the Company's capital structure.

Staff also suggests that the Company should simply issue more common stock as a means to improve its capital structure. (Hill Direct Testimony, pp. 25-27 and Tr. 905.) However, as explained by Mr. Wood, the issuance of additional common stock should not be viewed in isolation because to understand the Company's current capital structure you need to analyze the circumstances of the Company, including, without limitation, the Company's operating and regulatory environments, the resulting achieved financial performance, and the Company's efforts to manage its capital structure. (Wood Rebuttal Testimony, pp. 17-18 and Wood Rejoinder Testimony, p. 4.) Also, when issuing additional shares of common stock, the Company must strive to preserve the integrity of existing capital and to maximize proceeds from new share offerings. (Wood Rebuttal Testimony, pp. 21-22.) If too many shares are issued, earnings per share will likely be diluted and negatively impact the price of the Company's stock. (*Id.*) Such a scenario would be detrimental to the integrity of existing capital and hinder the Company's ability to maximize proceeds from subsequent stock offerings. (*Id.*)

It is undisputed that the Company has improved and continues to improve its common equity ratio. (Wood Rejoinder Testimony, pp. 6-7 and 16.) The Company had a common equity ratio of 31.1% as of December 31, 1995 and the Company currently has a 37.0% common equity ratio as of June 30, 2005. (Wood Rejoinder Testimony, p. 7 and Wood Rejoinder Testimony, Exhibit No. TKW-1.)

As such, the Commission should reject the capitalization plan recommended by Staff and should adopt the hypothetical capital structure recommended by RUCO and the Company because the use of this hypothetical capital structure and Mr. Hanley's corresponding recommended return on equity results in an overall reasonable rate of return commensurate with returns on investments in other enterprises having corresponding risks, thus meeting the standards of a just and reasonable rate of return set forth in the Arizona Constitution and the United States Supreme Court decisions in *Hope* and *Bluefield*.

(3) *Rate of Return.*

The Company's proposed hypothetical capital structure, when combined with the corresponding proposed capital (debt, preferred, and common equity) cost rates, results in the Company's recommended overall rate of return of 9.24%. (Exhibit A-55.)[7] If approved, the CMT would provide Southwest with greater earnings stability and Mr. Hanley recommends a 25 basis point reduction to his return on common equity, which would result in an overall lower requested rate of return of 9.13%. (Exhibit A-55.)

A primary concern with the recommended return on common equity and the resulting overall rate of return recommendations of Staff and RUCO are how the recommendations might negatively impact the Company's ability to maintain its existing credit ratings and negatively impact its ability to attract capital on a reasonable basis. The credit rating impact is an important consideration since the Company's current bond ratings are "BBB-" by S&P, and "Baa2" by Moody's. (Wood Rebuttal Testimony, pp. 14-15 and 23.) Furthermore, there is added importance because Moody's credit rating outlook for the Company was recently revised from stable to negative. (*Id.*) It is also well known that a key factor used by credit rating agencies in evaluating the creditworthiness of a utility is the impact of utility ratemaking. This was recently highlighted by Standard & Poor's ("S&P") in an article that discussed the rating agencies analysis of a rate case and where it indicated that the analysis included the following: (1) whether the new rates are based on a rate of return consistent with the company's rating and (2) if the

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[7] Judge Nodes requested that Southwest file a late exhibit detailing the revised rate of return in light of Mr. Hanley's revisions to his cost of common equity capital component. (Tr. p. 795.)

utility is being afforded a legitimate opportunity to actually earn the authorized rate of return. (Wood Rebuttal Testimony, pp. 24-25 and Wood Direct Testimony, Exhibit TKW-3.) This was further highlighted in another S&P article wherein it noted: "Ratings improvement hinges on achieving better rates of return and rate design improvements in Arizona, . . ." (Wood Rejoinder Testimony, p. 17 and Wood Rebuttal Testimony, Exhibit TKW-4.)

Unfortunately, RUCO's recommendation of a return on common equity of 10.15% is 76 basis points less than the 10.91% average authorized rate of return on common equity for LDCs over the time period 2003 through June 2005. (Wood Rebuttal Testimony, p. 26.) Also, RUCO's recommended common equity ratio of 42% is 5.5 percentage points less than the average authorized common equity ratio of 47.5%. (*Id.*) Based on this comparison, it is clearly evident RUCO's recommendation is below the authorized returns being granted to other gas distribution companies and is not consistent with the *Hope* and *Bluefield* standards. See *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia et al,* 262 U.S. 679 (1923); *Federal Power Commission et al. v. Hope Natural Gas Co. City of Cleveland,* 320 U.S. 591 (1944).

More troubling is Staff's recommendation that is even more out-of-line from the average returns that are being granted to other natural gas LDCs. Staff's recommendation of a 9.5% return on common equity is 141 basis points less than the 10.91% average authorized rate of return on common equity, and Staff's recommended common equity ratio of 40% is 7.5 percentage points less than the average authorized common equity ratio of 47.5%. (Wood Rebuttal Testimony, p. 26.) Moreover, Staff's recommended rate of return, on a pretax basis, will not sustain, much less improve Southwest's current bottom of investment grade S&P bond rating of BBB-. (Hanley Rejoinder Testimony, p. 10 and Hanley Rejoinder Exhibit FJH-31).

As such, based on a comparison to the average authorized rate of returns, the recently awarded rate of returns for other local Arizona utilities, and the Company's recommendation, RUCO's and Staff's recommended returns are woefully inadequate and contrary to the standards set forth by the United States Supreme Court. *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia et al,* 262 U.S. 679 (1923); *Federal Power Commission et al. v. Hope Natural Gas Co. City of Cleveland,* 320 U.S. 591 (1944. As such, the Commission should adopt the Company's overall rate of return of 9.24% without the CMT and 9.13% with the CMT.

D. OPERATING INCOME AND RATE BASE ADJUSTMENTS.

1) Legal Argument.

Only Staff and RUCO have objected to certain operating income and rate base adjustments set forth by Southwest in its Application. Southwest contends that it has presented sufficient evidence establishing the reasonableness of each requested adjustment and its entitlement to recover each requested adjustment in rates. The Company further contends that Staff and RUCO have each failed to present evidence challenging the reasonableness of these adjustments or evidence to sufficiently negate the evidence presented by the Company demonstrating the reasonableness of each adjustment and its entitlement to recover each requested adjustment in rates. As such, an order permitting Southwest's recovery of the costs associated with its operating income and rate base adjustments is warranted.

i) Points and Authorities Re: Operating Income.

(1) *Authority of the Commission.*

As previously noted, the Commission has the "full power to, and shall, prescribe **just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected**" and, although the Commission's authority to prescribe rates for public utilities is plenary, **the Commission's rate-making authority is subject to the "just and reasonable" standards set forth in the Arizona Constitution**. (Emphasis added.) (Ariz. Const. art. 15, §3 and *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169 (2001)).

As such, when considering the various operating income and rate base adjustment proposals, this Commission is bound by the "just and reasonable" standards set forth in Article 15, §3 of the Arizona Constitution.

(2) *The Calculation of Rates and the Rate Making Process.*

It is generally recognized that the **establishment of just and reasonable rates** requires the consideration of three factors: (1) the utility's **operating expenses**; (2) the utility's **rate base**; and (3) a reasonable rate of return. (Emphasis added.) *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169, 1172 (2001) (citing *Scates v. Arizona Corporation Commission,* 118 Ariz. 531, 578 P.2d 612 (1978)); and *Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988). Accordingly, the general theory of utility regulation is that total revenue (or margin), including income from rates and charges, should be sufficient to meet a utility's operating costs and to provide the utility and its stockholders a reasonable rate of return on the utility's investment.

This general theory and the establishment of rates can further be illustrated by the following algebraic formula:

The sum of a utility's rates should equal R:

where: R = O + (B x r)

R = Revenue Requirement
O = Operating Expenses
B = Rate Base [Cost less depreciation of the utility's property]
r = Rate of Return allowed on the rate base

As illustrated in the foregoing algebraic formula, a utility's rates are essentially the sum of two distinct components: (1) its operating expenses and (2) its return on invested capital. This basic principle of ratemaking, whereby the regulating body establishes rates, which will permit the utility to recover its expenses plus a reasonable return on the value of property devoted to public use, is well recognized. *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169, 1172 (2001) (citing *Scates v. Arizona Corporation Commission,* 118 Ariz. 531, 578 P.2d 612 (1978)); and *Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988); and *Southern California Edison Company v. Public Utilities Commission et al.,* 576 P.2d 945 (Cal. 1978). As such, in the context of a general rate case and the establishment of rates, the **authorized recoverable amount of a utility's operating expense has a direct effect upon the calculation of its rates.**

(a) *The Recovery of Operating Expenses in the Context of a General Rate Case.*

The Arizona Administrative Code and the Arizona Revised Statutes do not expressly define "operating expenses" in the context of setting rates or in the context of a general rate case. However, other jurisdictions have defined "operating expenses" in the context of a general rate case or a ratemaking proceeding, and have also promulgated standards for when a utility is entitled to recover prudently incurred operating expenses in rates.

Generally, "a public utility is entitled to recover in rates those **expenses reasonably necessary to provide service to its customers and to earn a fair rate of return on investment and plant used and useful in providing service**" (emphasis added). *Butler Township Water Company v. Pennsylvania Public Utility Commission,* 473 A.2d 219, 221 (Pa. Commw. Ct. 1984) (where the **court rejected the public utilities commission's argument that rate case expenses should be shared because there was no evidence in the record that the expenses were unreasonable, imprudently incurred, or excessive in amount**); *see also, People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (Wash. 1985) (where the court found **prudent operating expenses must be allowed as part of the composition of rates**); and *City and County of San Francisco v. Public Utilities Commission et al.,* 490 P.2d 798 (Cal. 1971) (where the court found that the public utilities commission has the power to prevent a utility from passing on to ratepayers unreasonable costs for materials and services by **disallowing expenditures which the Commission finds unreasonable**). Furthermore, if properly incurred, "**an operating expense must be allowed as part of the composition of the rates, otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce**" (emphasis added) *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (1985) (quoting A. Priest, Public Utility Regulation 49, (1969) (quoting from *Mississippi River Fuel Corporation v. Federal Power Commission,* 163 F.2d 437 (D.C.Cir. 1949))).

Accordingly, several different jurisdictions have addressed a utility's authority to recover operating expenses and each of them has focused on the "reasonableness" of the operating expense when determining whether a utility is entitled to recover the "operating expenses" in rates.

(b) *The United States Supreme Court's Directive on the Recoverability of Operating Expenses*.

The United States Supreme Court also addressed the issue of when a utility should be permitted to recover a prudently incurred operating expense in the context of a general rate case. In *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63 (1935), West Ohio Gas Company requested the recovery of several different operating expenses in rates, including, the following: "unaccounted for gas" due to leakage, condensation, expansion, or contraction; distribution expenses incurred in the superintendence of distribution; work on customer premises incidental to gas service; change of meters; maintenance of local mains and equipment; procuring new business; and rate case litigation. In its order, the Public Utilities Commission of Ohio allocated certain of these expenses over all of West Ohio Gas' service territory instead of confining them to the service territory in question; the Commission reduced the amount of the sales and marketing expenses on grounds that anything more would be unnecessary and wasteful; and the Commission completely disallowed the rate case litigation expenses.

West Ohio Gas Company appealed the Commission order to the Supreme Court of Ohio who affirmed the Commission's order, then West Ohio Gas Company appealed to the Supreme Court of the United States.

On appeal, the Supreme Court of the United States found that there was no evidence justifying the reduction of the distribution and commercial expenses pertaining to unaccounted for gas, reading meters, keeping accounts, and sending out and collecting bills, and held that the reduction was arbitrary and tantamount to a taking under the Fourteenth Amendment of the United States Constitution. In arriving at this holding, the Supreme Court stated that "a public utility will not be permitted to include negligent or wasteful losses among its operating charges. The waste or negligence, however, must be established by evidence of one kind or another, either direct or circumstantial." (*Id.* at p. 68.)

With regard to sales and marketing expenses and the rate case litigation expenses, the United States Supreme Court held that West Ohio Gas should be permitted to recover these expenses because "**good faith is to be presumed on the part of the managers of a business**" and "**in the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay**," and the Court found there was insufficient evidence in the record to support a reduction of these expenses (emphasis added) (*Id.* at p. 72).

As such, contrary to RUCO's and Staff's arguments and analysis, the proper standard for determining the recovery of a utility's operating expense is whether the operating expense was prudently incurred. *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63 (1935); *Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988); *Butler Township Water Company v. Pennsylvania Public Utility Commission,* 473 A.2d 219, 221 (Pa.Cmwlth. Ct. 1984); and *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (Wash. 1985).

(3) *Staff and RUCO Have Failed To Present Sufficient Evidence To Support a Disallowance of the Company's Operating Income Adjustments.*

(a) *Transmission Integrity Management Program Expenses*.[8]

The Pipeline Safety Improvement Act of 2002 is federal legislation directing the Office of Pipeline Safety and the Research and Special Programs Administration divisions of the U.S. Department of Transportation to promulgate regulations prescribing standards for transmission pipeline risk analysis and adopting and implementing a pipeline integrity management program. (Mashas Direct Testimony, Exhibit A, pp. 19-21.) Southwest's Application includes an adjustment to recover the costs associated with its compliance with the Pipeline Safety Improvement Act, also known as Southwest's Transmission Integrity Management Program ("TRIMP"), that will be incurred by the Company prior to the effective date of rates in this proceeding and to recover a representative level of on-going costs that will result from the continued activities associated with TRIMP. (*Id.*) Furthermore, Southwest has been complying with other similar pipeline safety laws and regulations for more than 30 years prior to the promulgation of the Pipeline Safety Improvement Act of 2002. (Tr. p. 1102.) As such, the TRIMP expenses are a reasonable operating expense.

Staff does not contend that the TRIMP expenses that Southwest is including in its adjustment were not incurred by the Company, and Staff does not challenge the reasonableness of the operating expense. (Tr. pp. 1086-1087.) Rather, Staff challenges Southwest's recovery of TRIMP operating expenses on grounds that the costs should be shared between ratepayers and the shareholders, and relies upon a Public Utilities Commission of Nevada ("PUCN") decision as support for this concept. (Tr. p. 1082.) Staff also recommends the use of a tracking device and a separate line item surcharge on customer's bills for purposes of recovering the TRIMP costs. (Dorf Direct Testimony, pp. 11-14.) The Company does not believe a separate line item surcharge is necessary given the small amount of the surcharge that would be included on each customer's bill. (Mashas Rebuttal Testimony, p. 13.)

Staff's reliance upon the PUCN decision regarding TRIMP expenses is misplaced. By its own admission, Staff acknowledges that: the Nevada decision was not a general rate case decision, but instead, an application for a deferred accounting order; that a deferred accounting order is typically applied prospectively; and that the PUCN granted Southwest 100% deferral of its TRIMP costs, prospectively, to preserve Southwest's opportunity to recover those costs in its next general rate case, subject to a prudency review. (Tr. pp. 1088-1089.) Furthermore, Staff does not even challenge the reasonableness of the operating expenses, which is the proper standard for determining when operating expenses should or should not be recovered. *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63 (1935); *Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988); *Butler Township Water Company v. Pennsylvania Public Utility Commission,* 473 A.2d 219, 221 (Pa.Cmwlth. Ct. 1984); and *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (Wash. 1985).

Staff has failed to present any evidence suggesting that the expenses associated with TRIMP are unreasonable or that they have not actually been incurred. (Tr. pp. 1086-1087.) Consequently, Staff has failed to present sufficient evidence to support their requested disallowance and an order granting Southwest's full recovery of TRIMP related operating

[8] RUCO and Southwest are not in dispute regarding Southwest's recovery of TRIMP related costs. (Diaz Cortez Surrebuttal Testimony, p. 14.)

expenses is warranted.

(b) *Sarbanes-Oxley Expenses*.[9]

Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX") is federal legislation that requires the establishment of an internal control structure and certain procedures for financial reporting, including that the annual report contain an internal control report. (Aldridge Direct Testimony, pp. 21-22.) In its Application, Southwest includes an adjustment requesting the recovery of the expenses related to the initial assessment and review of Southwest's internal controls and additional post-test year expenses required to fully implement the requirements of the federal legislation, as well as expected incremental and recurring compliance costs related to increased annual audit fees. (Aldridge Rebuttal Testimony, pp. 9-13.) Since its Application filing, Southwest has updated the estimated costs for compliance with SOX to reflect the actual costs that have been incurred in complying with this federal mandate, and has presented testimony demonstrating the reasonableness of the amount of costs due to Southwest's utilization of internal labor (exempt employees working uncompensated overtime) to keep the implementation costs lower than they otherwise would have been. (*Id.*) As such, the SOX related costs are a reasonable operating expense.

While Staff acknowledges that Southwest's costs of complying with the federal mandate are reasonable, they propose a 100% disallowance of Southwest's implementation costs and a 25% reduction of its audit costs on grounds that they are not recurring. (Dorf Direct Testimony, pp. 15-17 and Tr. pp. 1085-1086.) Staff also requests an equal sharing of the remaining compliance costs (audit fees) between shareholders and customers because Staff asserts that

[9] RUCO and Southwest are not in dispute regarding Southwest's recovery of its costs for complying with SOX. (Tr. p. 984.)

SOX was designed to benefit shareholders. (Dorf Direct Testimony, pp. 15-17; Dorf Surrebuttal Testimony, pp. 6-7; and Tr. p. 1083.)

As noted above, the standard for determining the recoverability of a utility's operating expense is whether the operating expense is reasonable, not a determination based upon vague and subjective notions of equity. *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63 (1935)*; Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988); *Butler Township Water Company v. Pennsylvania Public Utility Commission,* 473 A.2d 219, 221 (Pa.Cmwlth. Ct. 1984); and *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (Wash. 1985). If the standard were an analysis of who benefits from the operating expense, you could make an argument, based upon vague and subjective notions of equity that every operating expense, either directly or indirectly, benefits both the shareholder and the customer. Accordingly, Staff's argument that the costs should be shared because they benefit shareholders is simply illogical and unsupported by law. (*Id.*)

Staff has failed to present evidence challenging the reasonableness of the requested SOX expense, admits the costs are reasonable, and acknowledges that they have no evidence that 25% of the audit costs will be nonrecurring and their recommendation is based on speculation. (Dorf Direct Testimony, pp. 15-17 and Tr. pp. 1085-1087.) As such, Staff's recommended disallowance of 50% of the costs to comply with this federal mandate should be denied and an order permitting Southwest to recover its entire adjustment in rates is proper.

(c) *Total Compensation of 37 Employees.*

RUCO proposes to disallow the total compensation of 37 Southwest employees simply because RUCO incorrectly surmised that those employees' sole responsibilities are related to the functional areas of marketing and/or sales. (Moore Direct Testimony, pp. 15-16.)

The record clearly identifies the current job responsibilities and functions of the 37 employees including, without limitation, the following: advising customers on gas products and availability; coordinating new business processes; working with customers to determine technical needs and specifications; investigating and settling customer complaints; participating in customer business meetings as consultant/advisor; establishing programs to educate customers; making presentations to trade allies or potential customers; keeping up-to-date on government regulations impacting company products/services; keeping abreast of technology or other changes within the industry; and participating in workshops, hearings, open meetings, and consumer comment sessions. (Palacios Rebuttal Testimony, pp. 2-6 and Tr. pp. 85-91 and 107-109.). Furthermore, as explained by Company witness Christina Palacios, these employees are simply in the best position to elicit feedback from Southwest's customers and the marketplace, and are essential to Southwest's business. (Palacios Rebuttal Testimony, p. 4.) As explained by Ms. Palacios, the 37 employees job responsibilities and functions are even less focused on sales and marketing than the similarly situated employees in the last general rate case where the Commission chose not to disallow any of the their compensation. (Tr. pp. 85-91 and 107-109.) As such, the total compensation of these 37 employees is reasonable.

RUCO did not request any information regarding these employees, not their job descriptions or their job duties. (Aldridge Rebuttal Testimony, pp. 7-9) RUCO simply totaled the number of employees who received incentive pay and recommended a disallowance without knowing the job titles, job descriptions, or job responsibilities. (Tr. pp. 937-939 and Exhibits A-44-A4-6.) In fact, RUCO acknowledges that the information that it relied upon was the job descriptions and job responsibilities that were provided to them in a previous rate case proceeding, not information from a data request in this proceeding, and not testimony from a witness in this proceeding. (Tr. p. 939.) Moreover, RUCO relied upon job titles and job descriptions from a rate case proceeding where the Commission chose not to disallow any of the compensation of a similarly situated group of employees because it determined that, based upon the job titles and job descriptions in that proceeding, the individuals may engage in some marketing activities, but that they do much more than that, including coordinating the entire process of delivering gas to a specific site. (Tr. p. 940 and Arizona Corporation Commission Decision No. 64172, Exhibit A-43, p. 11, lns. 5-9.)

RUCO has failed to present sufficient evidence to support a disallowance of the total compensation of the 37 employees by failing to present evidence that the total compensation is unreasonable and, instead, has relied upon stale information, that even at the time, was information the Commission found insufficient to support a disallowance of compensation paid to similarly situated employees.

Moreover, contrary to RUCO's arguments that the recovery of certain sales and marketing expenses is not proper for recovery, the United States Supreme Court has specifically addressed the issue regarding the recovery of business development expenses when it stated:

> We take judicial notice of the fact that gas is in competition with other forms of fuel, such as oil and electricity. A business never stands still. It either grows or decays. Within the limits of reason, **advertising or development expenses to foster normal growth are legitimate charges** upon income for rate purposes as

> for others. **When a business disintegrates, there is damage to the stockholders, but damage also to the customers in the cost or quality of service** (emphasis added). *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63, 72 (1935).

As such, to the extent the 37 employees do engage in sales and marketing activities, it is a small percentage of their time, and thus their total compensation should be a permissible cost of service.

As such, RUCO's proposed disallowance of $2,892,434 should be denied and an order permitting Southwest to recover the total compensation of the 37 employees in rates.

(d) *Management Incentive Program*.

Southwest provides compensation to certain eligible employees through its Management Incentive Program ("MIP") based upon the Company's achievement of five factors that were designed to align the interests of customers and shareholders. (Mashas Rebuttal Testimony, pp. 6-11; Exhibit 52; and Tr. pp. 66-74.) Southwest submits that each of the five factors used by Southwest aligns customer and shareholder interests by increasing productivity which reduces the average cost of serving customers; maximizing productivity and utilizing customer satisfaction surveys to ensure that management's achievement of the customer-to-employee ratio goals is not at the expense of customer satisfaction; and controlling costs and maintaining a high quality of service resulting in high customer satisfaction. (*Id.*) Furthermore, the MIP is also a tool that helps Southwest retain quality employees by deferring 60% of the payout under the MIP for three years. (*Id.*) As such, employees who are awarded compensation under the MIP only receive 40% in the year of the payout and must continue their employment at Southwest for a period of three years to receive the remaining 60% of the compensation.[10] (*Id.*)

[10] Subject to normal retirement.

Staff and RUCO do not challenge the reasonableness of the operating expense. (Tr. pp. 986-88, 1087-1088, and 1093.) However, Staff and RUCO both propose disallowances associated with the MIP based upon arguments that the cost should be shared by customers and shareholders. (Dorf Direct Testimony, p. 20; and Diaz Cortez Direct Testimony, pp. 22-23.) Staff, while acknowledging the MIP rewards improvements in operating efficiency, submits that the other elements reward achievement of earnings targets and should thus be shared equally (50% disallowance) between customers and shareholders. (Dorf Direct Testimony, p. 20.) RUCO proposes a 67% disallowance arguing that the performance targets of return on equity, customers per employee, and customer satisfaction primarily benefit shareholders and not customers, and that the MIP is not known or measurable because it is a bonus program and could be as little as zero in any particular year. (Diaz Cortez Direct Testimony, pp. 22-23.)

As noted above, the standard for determining the recoverability of a utility's operating expense is whether the operating expense is reasonable, not a determination based upon vague and subjective notions of equity. *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63 (1935)*; Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988); *Butler Township Water Company v. Pennsylvania Public Utility Commission,* 473 A.2d 219, 221 (Pa.Cmwlth. Ct. 1984); and *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (Wash. 1985). If the standard were an analysis of who benefits from the operating expense, you could make an argument, based upon vague and subjective notions of equity that every operating expense, either directly or indirectly, benefits both the shareholder and the customer. Accordingly, Staff's argument that the costs should be shared because they benefit shareholders is simply illogical and unsupported by law. (*Id.*)

Moreover, Staff and RUCO do not challenge the reasonableness of the total compensation of this group of employees. In fact, Staff even admits that the costs were appropriate. (Tr. pp. 986-88, 1087-88, and 1093.) As such, the full cost of MIP should be a permissible cost of service. See, *Public Service Commission v. Ely Light and Power Company*, 393 P.2d 305 (Nev. 1964) (**where court held that different benefit plans are part of the overall cost of salaries and wages, and unless proven to be unreasonable, they are properly included in rates**).

As such, based upon the foregoing, Staff's and RUCO's proposed disallowances of 50% and 67%, respectively, should be denied and an order permitting Southwest to recover the full cost of MIP as a permissible cost of service is warranted.

(e) *Supplemental Executive Retirement Plan*.

Southwest offers a Supplemental Executive Retirement Plan ("SERP") to its officers to ensure that their retirement and deferred compensation portions of their total compensation are on parity with all other employees of Southwest whose retirement distributions are not impacted by certain IRS regulations. (Mashas Rebuttal Testimony, pp. 2-6.) As such, the SERP related operating expenses are reasonable.

RUCO challenges the Company's request to recover its SERP costs by asserting that the SERP is not a necessary cost of providing gas service. (Moore Direct Testimony, pp. 28-29.) RUCO further contends that customers should not be responsible to pay the cost of supplemental benefits to a small select group of high-ranking officers of the Company. (Moore Surrebuttal Testimony, pp. 22-24.)

As noted above, the standard for determining the recoverability of a utility's operating expense is whether the operating expense is reasonable. *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63 (1935)*; Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (Tex. 1988); *Butler Township Water Company v. Pennsylvania Public Utility Commission,* 473 A.2d 219, 221 (Pa.Cmwlth. Ct. 1984); and *People's Organization for Washington Energy Resources v. Washington Utilities and Transportation Commission,* 711 P.2d 319 (Wash. 1985). RUCO presented no evidence challenging the reasonableness of the overall compensation of the Company's executives and failed to cite to any significant change in circumstances with the company or the SERP as a basis for its proposed disallowance. (Tr. pp. 932-933.) Furthermore, consistent with prior Commission decisions, absent a showing that the overall compensation package to the Company's top executives is excessive, the Commission has historically refused to disallow such an expense. Arizona Corporation Commission Decision No. 64172, Exhibit A-43, p. 15, lns. 3-6.; see also, *Public Service Commission v. Ely Light and Power Company*, 393 P.2d 305 (Nev. 1964) (**where court held that different benefit plans are part of the overall cost of salaries and wages, and unless proven to be unreasonable, they are properly included in rates**).

As such, based upon the foregoing, RUCO's proposed disallowance of $1,566,073 should be denied and an order permitting Southwest to recover the full cost of SERP as a permissible cost of service is proper.

(f) *Miscellaneous Expenses*.

RUCO failed to present sufficient evidence supporting a disallowance of various miscellaneous expenses. According to RUCO witness Rodney L. Moore, he simply reviewed the Company's response to data request number 11-1 (which was received by him on or about June 19, 2005), as a basis for his recommended disallowance. (Tr. p. 925.)

However, as noted by Company witness Randi Aldridge, RUCO relies upon 40 pages of work papers that simply have a vendor name, a dollar amount, and an invoice number. (Tr. p. 577; Aldridge Rebuttal and Rejoinder, p. 16.) Southwest contends that these workpapers are insufficient to make a determination regarding the reasonableness of the expense. (Tr. p. 577; Aldridge Rebuttal and Rejoinder, p. 16.) Moreover, in Exhibit RLA-6 to Ms. Aldridge's rebuttal testimony (in support of Southwest's requested recovery), she classified transactions by account, and further described the categories that were not self-explanatory. (Tr. p. 578; Aldridge Rebuttal Testimony, pp. 16-17.) As such, after analyzing each transaction, the Company determined that it would be appropriate to accept a disallowance of $62,163 and is continuing to request the remaining amount of its initial adjustment because the expenses are reasonable and necessary. (Aldridge Rebuttal Testimony, pp. 15-16 and Aldridge Rebuttal Exhibit RLA-5.)

In RUCO's surrebuttal testimony, Mr. Moore acknowledges that he did not review the additional information provided by Southwest in rebuttal. (Moore Surrebuttal Testimony, p. 21.) As such, RUCO did not consider the Company's removal of $62,163 from its original adjustment when he offered to reduce his proposed disallowance by 20%. (Moore Surrebuttal Testimony, p. pp. 21-22.) Accordingly, after the Company responded to RUCO's concerns and revised its request, RUCO failed to provide further analysis of the revised information that was provided by the Company and never responded to the Company's rebuttal evidence setting forth the reasonableness of the operating expenses. (Moore Surrebuttal Testimony, p. 21.)

As such, RUCO's proposed disallowance of $277,039 should be denied and the Company's adjustment of $62,163 that was proposed in its rebuttal testimony should be accepted.

(g) *American Gas Association Dues.*

RUCO contends that the portion of the dues paid to the American Gas Association ("AGA") that pertain to lobbying, marketing, and promotional activities, including communications and public affairs, should be carved out and removed from the Company's requested cost of service. (Moore Direct Testimony, pp. 21-22 and Tr. p. 923.)

Ms. Aldridge presented in her rejoinder testimony a list of the various AGA due cost centers and the descriptions of the cost centers in Exhibit RLA-1. (Aldridge Rejoinder Testimony, pp. 16-17 and Tr. p. 590.) As noted in Exhibit RLA-1 to Ms. Aldridge's rejoinder testimony, the list of cost centers include, market development, which is listed separately from the communications cost center. (*Id.*) Furthermore, the market development cost center is described by the AGA as: to "Assist members in their efforts to encourage the most efficient utilization of gas energy by exchanging information about marketing trends, conducting utilization efficiency programs, and exploring market opportunities." (Aldridge Rebuttal Testimony, pp. 13-14 and Aldridge Rejoinder Testimony, Exhibit RLA-1.) Whereas, the communication cost center is described by the AGA as "Develops informational materials for member companies and consumers and coordinates all media activity" and the public affairs cost center is described by the AGA as "provides members with information on legislative developments; prepares testimony, comment, and filings regarding legislative activities; lobbies on behalf of the industry." (*Id.*) Moreover, Southwest removed the market development cost center from the AGA dues and removed the lobbying portion from the public affairs cost center prior to filing its Application. (Tr. pp. 549 and 590-91.) As such, the AGA dues is a reasonable operating expense.

There is no evidence in this proceeding establishing that the communication and public affairs portion of the AGA dues are an unreasonable operating expense. (Tr. pp. 590-591.) Furthermore, contrary to RUCO's arguments that the recovery of certain promotional and marketing expenses are not proper for recovery, the United States Supreme Court has stated that "within the limits of reason, **advertising or development expenses to foster normal growth are legitimate charges** upon income for rate purposes as for others." *West Ohio Gas Company v. Public Utility Commission of Ohio,* 294 U.S. 63, 72 (1935). As such, to the extent there is any promotional and marketing benefits associated with the communication and public affairs cost centers of the AGA dues, they are minimal and reasonable, and should thus be a permissible cost of service.

As such, RUCO's proposed disallowance of $75,385 of AGA dues should be denied, and an order authorizing the Company to recover the full amount of its proposed adjustment pertaining to AGA dues in rates is proper.

(h) *Labor Annualization and 2005 Wage Increases*.[11]

RUCO contends that the inclusion of the 2005 wage increases result in double counting and creates a mismatch between revenues and expenses. (Tr. pp. 929-930.) However, RUCO

[11] Staff accepts the inclusion of the 2005 wage increases because they are known and measurable. (Tr. p. 1085.)

acknowledges that the Company's labor annualization adjustment is one adjustment that simply reflects two different wage increases, one for 2004 and one for 2005, and RUCO further acknowledges that the wage increases only apply to employees that were serving test year customers. (Tr. pp. 929-930 and 932.)

As explained by Ms. Aldridge, the 2005 wage increases are known and measurable, and the wage increases that are included in the labor annualization adjustment only apply to employees who were on the Company's payroll at the end of the test period. (Tr. p. 545.) As such, the adjustments do not create a mismatch between revenues, expenses, and the other cost of service items requested by the Company. (*Id.*) Furthermore, the Company's position on this issue is consistent with prior Commission decisions wherein the Commission has permitted post-test year wage increases when the wage increase was known and measurable and it applied to test year employees who were serving test year customers, and thus, not resulting in a mismatch of revenue and expenses. (Arizona Corporation Commission Decision No. 64172, Exhibit A-43, p. 11, lns. 10-13.)

As such, RUCO's proposed disallowance of the 2005 wage increases should be denied because the amounts are known and measurable and are limited to those employees who were serving test year customers at the end of the test year, and an order authorizing the Company to recover the wage increases in rates is warranted.

ii) Points and Authorities Re: the Determination of Rate Base.

(1) *Authority of Commission.*

As previously noted, the Commission is charged with prescribing "**just and reasonable classifications to be used and just and reasonable rates and charges to be made and**

collected." (Emphasis added.) (Ariz. Const. art. 15, §3.). "The corporation commission shall, to aid it in the proper discharge of its duties, ascertain the fair value of the property within the state of every public service corporation doing business therein" (Ariz. Const. art 15, §14). However, the Commission's authority is subject to the **just and reasonable** clauses of Article 15, Section 3 of the Arizona Constitution. *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169 (2001).

(2) *The Calculation of Rate Base.*

These standards also apply to establishing the utility's rate base because the **establishment of just and reasonable rates** requires the consideration of three factors: (1) the utility's **operating expenses**; (2) the utility's **rate base**; and (3) a reasonable rate of return. (Emphasis added.) *Residential Utility Consumer Office v. Arizona Corporation Commission,* 199 Ariz. 588, 20 P.3d 1169, 1172 (2001) (citing *Scates v. Arizona Corporation Commission,* 118 Ariz. 531, 578 P.2d 612 (1978)); *Public Utility Commission of Texas v. Houston Lighting & Power Company,* 748 S.W.2d 439 (1988).

Furthermore, with respect to items which are included in "rate base," the utility is permitted to receive a return "of" and "on" amounts invested in those assets. *In Re Public Service Company of New Hampshire,* 114 B.R. 820, 845 (1990). The return "of" the investment is provided in the form of an allowance of depreciation or amortization as an expense. *Id.* The return "on" those items is provided through the allowance of the rate of return on the unamortized balance. *Id.* Whether an item will be permitted to be included in rate base will depend on whether and to what extent expenditures were **"prudently incurred"** and whether the resulting asset is **"used and useful"** in providing service to the public. *Id.* at 846.

As such, in the context of a general rate case and the establishment of rates, the **authorized recoverable amount of a utility's rate base adjustments has a direct effect upon the calculation of its rates.**

(3) ***Staff and RUCO Failed To Present Sufficient Evidence To Support a Disallowance of the Company's Rate Base Adjustments.***

(a) <u>*Deferred Taxes*</u>.

Staff contends that the Company's proposed adjustment was not required because it elected to change its method of accounting and that the proposed adjustment to deferred taxes is distinguishable from the property tax adjustments that it supports in this proceeding because the property tax is an expense that affects operating income, as opposed to deferred income taxes that are a component of rate base. (Tr. p. 1084.)

Contrary to Staff's implication, Southwest is not electing to change a method of accounting to take advantage of a change in law. Southwest made an election in 2002 in an attempt to benefit its customers by reducing its deferred taxes and lower its rate base. (Tr. pp. 500-01.) However, on August 3, 2005, the Internal Revenue Service issued regulations and a revenue ruling relating to the capitalization of costs under two simplified methods that were contained in the previously-issued regulations under Code Sec. 263A uniform capitalization (UNICAP) rules. (Moses Rebuttal Testimony, p. 6.) The new regulation and ruling requires Southwest to include in income in 2005 and 2006 the cumulative tax deduction taken under the old UNICAP regulations with respect to the simplified service cost method (SSCM). (Moses Rebuttal Testimony, p. 7.) As such, <u>this change is mandatory</u> and not elective. (Moses Rebuttal Testimony, Exhibit LEM-1 and Tr. p. 491.) Moreover, this change does nothing more than put Southwest in a similar position to what it would have been had it not made the election in 2002.

Furthermore, contrary to Staff's contention that the adjustment is improper because all components of rate base should be measured on the same date, and that date is the end of the test year, this adjustment is consistent with prior Commission decisions wherein the Commission has made post-test year rate base adjustments for projects that were known and measurable and where Staff also supported post-test year rate base adjustments that were one year beyond the test period. (Tr. p. 1084 and Arizona Corporation Commission Decision No. 64172, Exhibit A-43, p. 6.) Similar to the circumstances pertaining to the Upper Bisbee Project and the Building Encroachment Project that Southwest was granted post-test year rate base adjustments in Decision No. 64172, the deferred taxes adjustment is known and measurable and the change in law occurred within one year from the end of the test period, and prior to the time rates from this proceeding will go into effect. (Tr. pp. 489, 492-93, and 500-01.) Accordingly, Southwest's proposed decrease in deferred taxes and increase in rate base of $21,120,694 is just and reasonable.

Similar to the recent changes in Arizona law pertaining to property taxes that both Staff and RUCO argue, the effects of which, should be included in this proceeding because the changes take effect on January 1, 2006 and will be in effect prior to the date rates from this proceeding will be in effect, the regulations and revenue ruling pertaining to deferred taxes took effect in August of 2005 and are also effective prior to the time rates from this proceeding will be in effect. (Tr. p. 489; Rogers Direct Testimony, pp. 5-6; and Moore Direct Testimony, pp. 26-27.) As such, the effect of this change in law should also be included in this proceeding. No one is challenging the veracity of the adjustment, but rather Staff wants to pick and choose what recent changes in law should be reflected in this proceeding. If any post-test period change in law is acknowledged and included in this proceeding, then all proposed post-test period changes in law should be included in this proceeding.

(b) *Completed Construction Not Classified - Rate Base and Operating Income Adjustment*.

RUCO contends that only work orders whose in-service date falls within the test year should be included in the adjustment for completed construction not classified ("CCNC"). (Moore Direct Testimony, p. 8.)

Contrary to RUCO's assertions, Southwest requests **only include tangible plant that was in-service at the end of the test year**. (Tr. p. 588.) Southwest is also only requesting the recovery of dollars that were associated with plant that was **used and useful at the end of the test year** and that were **known and measurable at the end of the test year.** Southwest request is consistent with prior Commission decisions. (Tr. p. 589.) As explained by Ms. Aldridge, Southwest's work orders have one in-service date and the in-service date reflects when the entire project has been completed, not necessarily when portions of the project are completed, i.e. the street has been paved and the gas is flowing through the pipe for the various completed portions of the work orders. (Tr. pp. 537-538.) Furthermore, RUCO Exhibit R-9, is a copy of Section 106 of the National Association of Regulatory Utility Commissioners Uniform System of Accounts for Class A and B Gas Utilities, pertaining to CCNC, and it indicates that the CCNC account shall include the **balances of work orders for utility plant which has been completed** and placed in service, and does not necessarily require the entire work order, itself, to be completed. (Tr. pp. 536-537 and Exhibit R-9.)

As such, based upon the foregoing, RUCO's proposed rate base disallowance of \$1,601,627 and the corresponding depreciation expense disallowance of \$72,727 should be denied, and an order authorizing Southwest to include those portions of work orders that are used and useful and known and measurable at the end of the test period in its rate base is warranted.

(c) *Pipe Replacement – Rate Base and Operating Income Adjustment*.

RUCO contends that Southwest should continue to write off a percentage of steel pipe replacements and RUCO also disagrees with the Company's proposal regarding the effective date for applying the new percentages to pipe replacement write offs of Aldyl HD pipe. (Diaz Cortez, Surrebuttal Testimony, pp. 12-13 and Tr. p. 985.)

RUCO does not present evidence challenging Southwest's contention that none of the steel pipe was replaced due to defective material and/or installation, and was thus not subject to the settlement agreement in Docket Number U-1551-93-272. (Tr. p. 985.) To the contrary, RUCO's proposed disallowance is based solely on a misunderstanding of the data that was provided to it by the Company. (Tr. p. 985.) RUCO is purportedly only recommending a disallowance of the steel pipe portion because it believed that the information provided to it by Southwest in data request number 15-1 represented pipe replacements that were subject to the settlement agreement. (*Id.*) However, RUCO, in data request 15-1, requested the amount of all pipe replacements during the time period of 2000-2004. (Exhibit A-47.) RUCO did not request the pipe replacement write offs that were subject to the settlement agreement in Docket Number U-1551-93-272. (*Id.*) Furthermore, the response to the data request specifically stated "The pipe footage and resulting cost is for all pipe replaced, and not necessarily for pipe replaced due to defective material or faulty installation practices." (Emphasis added.) (Exhibit A-47.) As such, RUCO's recommendation regarding pipe replacement for steel pipe is purportedly based upon its misunderstanding of the information provided to it by the Company in response to data request 15-1. RUCO's recommended disallowance regarding steel pipe is also unfounded because

RUCO has presented no evidence contradicting Southwest's contention that by 1998 all steel pipe was cathodically protected and was thus in fact no longer subject to the terms of the settlement agreement. (Tr. p. 985.)

With regard to the effective date of the write-off percentages, as explained by Company witness Robert Mashas, Southwest submits that the Commission has the authority to adopt the Company's proposal to calculate write-off percentages based on a new 40 year standard and to have it apply to pipe replacement beginning January 1, 2000. (Mashas Rebuttal Testimony, p. 15.) The Company is not asking to restate plant write-offs that were previously disallowed (for instance, to plant write-offs recorded prior to the end of the test year in the Company's last rate case). (Mashas Rebuttal Testimony, p. 16.) Moreover, RUCO agrees with the Company that the Commission has the authority to determine the ratemaking treatment of any asset that is put in place during the time period since the Company's last rate case. (Diaz Cortez Surrebuttal, pp. 12-13.)

This is a new rate case and the Commission has the authority, pursuant to Article 15, §§ 3 and 14 of the Arizona Constitution, to determine the appropriateness of any capital expenditure for inclusion or exclusion in rate base. As such, the effective date for the write-off percentages should be January 1, 2000 (the day after the test year-end in the Company's last general rate case), and an order permitting Southwest to begin using the new write off percentages as of January 1, 2000 is proper.

IV.
CONCLUSION

At the outset of this brief, Southwest respectfully implores the Administrative Law Judge and the Commissioners to seize this unique and timely opportunity to improve Southwest's ability to realize the level of revenues authorized by the Commission in this case which, for all of the reasons stated, would ultimately impact the customers of Southwest favorably through lower capital costs.

Cutting through what can be expected to be hundreds of pages of briefing materials, independent of the hundreds of pages of prefiled testimony, transcriptions and exhibits, there are three essential determinations that are critical to the outcome of this general rate case: (1) the recovery of reasonable, ongoing operating costs, (2) a realistic estimation of Southwest's cost of capital in relation to the proxy groups utilized by the cost of capital witnesses and (3) either through the design of rates or the approval of a mechanism decoupling margin recovery from consumption levels, or both, an improved opportunity for Southwest to actually realize the authorized level of revenues.

Southwest's proposed decoupling mechanism, or a modified version preferred by the Commission, would result in a win-win for all stakeholders. It would remove the inherent disincentive to aggressively promote conservation and energy efficiencies which necessarily would erode earnings, it would strengthen Southwest's financial profile, all to the benefit of Southwest's investors and customers, and it would shield Southwest's customers from the potential that Southwest would over-recover the authorized level of margin in the event of an abnormally cold heating season.

In conclusion, Southwest respectfully requests that the Administrative Law Judge recommend and that the Commissioners authorize (1) the recovery of all reasonable, ongoing operating costs, (2) a cost of capital that meets the letter and the spirit of the *Hope* and *Bluefield* standard, which is embraced as the appropriate standard by all of the cost of capital witnesses, and (3) a rate design and/or decoupling mechanism which improves Southwest's opportunity to actually realize the level of revenues authorized in this case.

DATED this 4th day of November 2005.

RESPECTFULLY SUBMITTED BY:

SOUTHWEST GAS CORPORATION

Andrew W. Bettwy, Esq.
Karen S. Haller, Esq.
Justin Lee Brown, Esq.
Legal Department
5241 Spring Mountain Road
Las Vegas, Nevada 89102
(702) 876-7107
(702) 252-7283 – FAX

ORIGINAL and 13 COPIES of the foregoing filed this 4th day of November 2005, with:

Docket Supervisor
Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

COPIES of the foregoing served by regular mail and e-mail this _____ day of November 2005, on:

Sheryl Carter, Director
Western Energy Programs
Natural Resources Defense Council
111 Sutter Street, 20th Floor
San Francisco, CA 94204
scarter@nrdc.org

Walter W. Meek
Arizona Utility Investors Association
2100 North Central Avenue, Suite 210
Phoenix, AZ 85004
info@auia.org

Raymond S. Heyman
Laura E. Sixkiller
ROSHKA, HEYMAN & DeWULF, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, AZ 85004
rheyman@rhd-law.com
lsixkiller@rhd-law.com
Attorneys for Tucson Electric Power Company

Cynthia Zwick
Arizona Community Action Association
2700 North 3rd Street, Suite 3040
Phoenix, AZ 85004
info@azcaa.org

Michelle Livengood
TUCSON ELECTRIC POWER COMPANY
One South Church Street, Suite 200
Tucson, AZ 85702
mlivengood@tep.com

Thomas H. Campbell
LEWIS AND ROCA
40 North Central Avenue, Suite 1900
Phoenix, AZ 85004
tcampbell@lrlaw.com
Attorneys for Yuma Cogeneration Associates

Thomas L. Mumaw
Karilee S. Ramaley
Pinnacle West Capital Corporation, MS 8695
Phoenix, AZ 85004
thomas.mumaw@pinnaclewest.com
karilee.ramaley@pinnaclewest.com
Attorneys for APS

Timothy M. Hogan
ARIZONA CENTER FOR LAW IN THE PUBLIC INTEREST
202 East McDowell Road, Suite 153
Phoenix, AZ 85004
thogan@aclpi.org
Attorneys for SWEEP/NRDC

Peter Q. Nyce, Jr.
General Attorney
Regulatory Law Office
U.S. Army Legal Services Agency
901 North Stuart Street, Room 713
Arlington, VA 22203-1837
peter.nyce@hqda.army.mil

Christopher Kempley, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007
ckempley@cc.state.az.us

Jason Gellman
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007
ckempley@cc.state.az.us

Diane Dargovnik
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007
ckempley@cc.state.az.us

Scott S. Wakefield
RUCO
1110 West Washington, Suite 220
Phoenix, AZ 85007
swakefield@azruco.com

Ernest G. Johnson, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007
ejohnson@azcc.gov

Dan Neidlinger
Neidlinger & Associates
3020 North 17th Drive
Phoenix, AZ 85015
dneid@cox.net

Penny Tvrdik
Senior Attorney
MidAmerican Energy Holdings Company
302 South 36th Street
Omaha, NE 68131
penelope.tvrdik@nngco.com
Attorney for Yuma Cogeneration Associates

Jeff Schlegel
SWEEP Arizona Representative
1167 West Samalayuca Drive
Tucson, AZ 85704-3224
schlegelj@aol.com

an employee of Southwest Gas Corporation

SOUTHWEST GAS CORPORATION'S POST-HEARING BRIEF

APPENDIX 1

APPENDIX 1

Southwest Gas Corporation
Arizona
Docket No. G-01551A-04-0876

JURISDICTION	TITLE OF PROCEEDING	DOCKET NO.
Arizona	Re Resources Planning	No. U-0000-90-088
California	In re Proposed Policies Governing Restructuring California's Elec. Services Industry and Reforming Regulation	Nos. R.95-05-045, R.94-04-031, I.94-04-032
California	In re Establish Rules and Procedures Governing Utility Demand-Side Management	Nos. R.91-08-003, I.91-08-002
Colorado	In re Public Service Co. of Colorado	Nos. 93I-199EG, C95-1305
Colorado	Re Public Service Co. of Colorado	Nos. 93I-199EG, C94-764
Colorado	In re Public Service Co. of Colorado	Nos. 93I-199EG, C94-344
Colorado	Re Public Service Co. of Colorado	Nos. 91A-480EG, C93-38
Colorado	Re Public Service Company of Colorado	Nos. 90A-743EG, C91-1544
Connecticut	Re Yankee Gas Services Company	No. 92-02-19
D.C.	In re Potomac Power Co.	No. 917 (Phase II)
D.C.	Re Potomac Elec. Power Co.	Nos. 929, 10387
D.C.	Re Potomac Elec. Power Co.	No. 905
D.C.	Re Potomac Elec. Power Co.	Nos. 917, 10155
Delaware	In re Delmarva Power and Light Co.	Nos. 92-98, 3760
Delaware	In re Delmarva Power and Light Co.	No. 40
Florida	Re Florida Power Corp.	Nos. 930444-EI, PSC-95-0097-FOF-EI
Florida	Re Florida Power Corp.	Nos. 910890-EI, PSC-92-1197-FOF-EI
Georgia	Re Georgia Power Company, et al	Nos. 4131-U, 4134-U
Hawaii	In the Matter of the Application of HAWAIIAN ELECTRIC COMPANY, INC	No. 04-0113, 21698, 05-0069
Hawaii	In re Hawaiian Elec. Co., Inc.	Nos. 94-0010, 94-0011, 94-0012, 14638
Hawaii	Re Proceeding to Require Energy Utilities to Implement Integrated Resource Planning	No. 6617
Idaho	In re Idaho Power Co	No. IP-E-01-13
Idaho	Re Washington Water Power Co.	Nos. WWP-E-92-1, WWP-G-91-1, 24417
Indiana	In re Board of Directors for Utilities of Dept. of Public Utilities of City of Indianapolis	Cause No. 42767
Iowa	In re Energy Policy Act of 1992 Title 1, 111, 115	No. INU-94-1
Kentucky	In re Kentucky's Elec. Generation, Transmission, Distribution Needs	No. 2005-00090
Kentucky	In re Union Light, Heat and Power Co.	No. 99-414
Kentucky	In re Louisville Gas and Elec. Co.	No. 97-083
Kentucky	In re Louisville Gas and Electric Co.	No. 10320
Kentucky	Re Louisville Gas and Elec. Co.	No. 93-150
Maine	Re Central Maine Power Co.	Nos. 90-085-A, 90-085-B, 92-174, 92-346
Maryland	In re Elec. Services, Market Competition and Regulatory Policies	No. 8678
Massachusetts	Re Integrated Resource Management Practices	No. D.P.U. 89-239
Michigan	Re Consumers Power Co.	No. U-10335
Minnesota	Re Northern States Power Co.	Nos. G-002/GR-92-1186
Montana	Re Montana Power Co.	No. 93.6.24, 5709D
Nevada	In re Southwest Gas Corp	No. 04-3011
New Jersey	In re Demand Side Management Resource Plan	No. EX90040304
New York	In re Consolidated Edison Co. of New York, Inc.	No. 04-E-0572
New York	In re Consolidated Edison, Inc.	Nos. 00-M-0095; 00-E-1208; 96-0897; 00-E-1461; 99-E-1020
New York	Matter of New York State Elec. & Gas Corporation's Plans Elec. Rate/Restructuring Pursuant to Opinion No. 96-12	Nos. 96-E-0891, 93-E-0960, 94-M-0349
New York	In re Orange & Rockland Utilities, Inc.	No. 96-E-0900, 97-20
New York	Matter of Orange and Rockland Utilities, Inc.'s Plans for Rate/Restructuring Pursuant to Option No. 96-12	No. 97-20

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Arizona
Docket No. G-01551A-04-0876

JURISDICTION	TITLE OF PROCEEDING	DOCKET NO.
New York	In re Long Island Lighting Co.	No. 93-E-1123
New York	In re Orange and Rockland Utilities, Inc.	No. 95-E-0491, 96-21, 93-M-0849, 93-G-0779
New York	In re Niagara Mohawk Power Corp.	Nos. 95-21, 94-G-0100, 94-E-0098, 29327, 94-E-0099
New York	Petition of New York State Elec. & Gas Corp.	Nos. 94-M-0349, 95-E-0425, 95-M-0017, 93-E-0664, 93-E-0284, 95-E-0426, 95-17
New York	Petition of York State Electric & Gas Corp.	Nos. 94-M-0349, 95-M-0017, 93-E-0284, 93-E-0664
New York	In re Proceeding on Motion of Com'n as to Rates, Charges, Rules and Regulations of Orange and Rockland Utilities, Inc. for Elec. Service	Nos. 95-E-0491, 93-M-0849
New York	Proceeding on Motion of Commission as to Rates, Charges, Rules, Regulations of Long Island Lighting Co. for Electric Service	No. 93-E-1123
New York	In re New York States Elec. and Gas Corp.	No. 94-E-0705
New York	In Matter of Competitive Opportunities Regarding Elec. Service	Nos. 94-E-0952, 95-7
New York	Proceeding of Orange and Rockland Utilities, Inc.	Nos. 93-E-0082, 89-E-175
New York	Proceeding on Motion of Orange and Rockland Utilities, Inc.	No. 93-E-0082
New York	In re New York States Elec. and Gas Corp.	Nos. 93-E-0601, 94-M-0349, 94-19
New York	In re Orange and Rockland Utilities, Inc.	Nos. 93-E-0082, 93-M-0849
New York	In re Long Island Lighting Co.	Nos. 93-G-0002, 93-23
New York	Re Orange and Rockland Utilities, Inc.	Nos. 92-G-0050, 93-E-0082, 93-M-0849
New York	In re New York State Elec. and Gas Corp.	Nos. 92-E-1084, 92-E-1085, 92-G-1086, 93-22
New York	In re New York State Elec. and Gas Corp.	Nos. 92-E-1084, 92-E-1085, 92-G-1086
New York	In re Rochester Gas and Elec. Corp.	Nos. 92-E-0739, 92-E-0740, 92-G-0741, 93-19
New York	In re Rochester Gas and Elec. Corp.	No. 91-G-0658
New York	In re Consolidated Edison Co. of New York, Inc.	Nos. 92-E-0875, 92-M-0605, 93-7
New York	In re Central Hudson Gas and Elec. Corp., et al	Nos. 92-E-0621, 92-E-0615, 92-E-0610, 92-E-0609, 92-E-0498, 92-E-0468, 92-E-0616, 92-G-0657, 92-G-0654
New York	Re Niagara Mohawk Power Corp.	Nos. 92-E-0108, 93-3
New York	Proceeding of Elec. Utilities	Nos. 93-2, 89-E-176
New York	Matter of Orange and Rockland Utilities, Inc	Nos. 92-30, 92-G-0050
New York	Re Consolidated Edison Company of New York, Inc.	CASE 91-E-0462
New York	Re Orange and Rockland Utilities, Inc.	Nos. 91-G-0128, 91-29
New York	Re Long Island Lighting Co.	Nos. 90-E-1185, 91-G-0112, 91-25
New York	Re Operation of Electric Fuel Adjustment Clause	No. 90E0954, 91-19
New York	Niagara Mohawk Power Corp.	Nos. 29327, 89-37(D)
New York	Orange and Rockland Utilities, Inc.	Nos. 89-E-175, 89-E-176
New York	Consolidated Edison Co. of New York, Inc.	Nos. 29523, 87-4(A)
Oregon	In the Matter of NORTHWEST NATURAL GAS	Nos. 051055, UG 166/UM 1216/UM 12
Oregon	In the Matter of NORTHWEST NATURAL GAS COMPANY	No. 05934
Oregon	In re Oregon's Regulated Gas Distribution Utilities	No. UM 903, 04-203
Oregon	In the Matter of NORTHWEST NATURAL GAS COMPANY	No. 03 662
Oregon	In re Northwest Natural	No. 02-800
Oregon	In re Portland General Elec. Co	No. 02-633
Oregon	In re Northwest Natural Gas Co	No. 02-634
Oregon	In re Northwest Natural Gas Co	No. 01-750
Oregon	In re PORTLAND GENERAL ELEC	No. 01-751
Oregon	In re PacifiCorp	Nos. UE 94 (Phase II); 98-191
Oregon	In re PacifiCorp	No. UE 94 (Phase II), 97-371
Oregon	In re Portland General Elec. Co	No. UE 100, 96-306
Oregon	In re PacifiCorp	No. UE 94, 96-175
Oregon	In re PacifiCorp	No. 95-800
Oregon	In re Portland General Elec. Co.	Nos. UM 762, 95-492

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Southwest Gas Corporation
Arizona
Docket No. G-01551A-04-0876

JURISDICTION	TITLE OF PROCEEDING	DOCKET NO.
Oregon	In re Portland General Elec. Co.	No. 95-322
Oregon	Re Elec. Utility Incentives for Acquisition of Conservation Resources	Nos. UM 409, 92-1673
Pennsylvania	In re Demand-Side Management by Elec. Utilities Uniform Cost Recovery Mechanism	No. I-900005
Virginia	In re Consideration of Standards for Integrated Resource Planning	No. PUE940030
Washington	Washington Utilities and Transp. Com'n v. PacifiCorp	No. UE-032065
Washington	Washington Utilities and Transp. Com'n v. Puget Sound Power and Light Co.	No. UE-950618
Washington	Washington Utilities and Transp. Com'n v. Puget Sound Power and Light Co	No. UE-930622
Washington	In re Puget Sound Power and Light Co.	Nos. UE-920433, UE-920499, UE-921262
Washington	Washington Utilities and Transp. Com'n v. Puget Sound Power and Light Co.	No. UE-930622
Washington	Washington Utilities and Transp. Com'n v. Puget Sound Power and Light Co.,	No. UE-920630
Washington	Re Puget Sound Power and Light Company	No. UE-910689
Washington	Washington Utilities and Transportation Commission v. Puget Sound Power and Light Company	No. UE-910626